TC07887

VALUE ADDED TAX – applications by the Appellant to debar the Respondents from proceedings in relation to an appeal against the denial of input tax and a related penalty and to determine the proceedings in favour of the Appellant due to deficiency in pleadings - application by the Respondents to amend statement of case – held, the Respondents application succeeded and the Appellant's applications failed but various parts of the amended statement of case, including those relating to the Appellant's being denied the right to deduct the input tax because it had had knowledge of its supplier's fraud, to be struck out

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/09560

BETWEEN

AMW ESTATES LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE TONY BEARE

The hearing took place on 5 October 2020. With the consent of the parties, the form of the hearing was by way of a video hearing on the Tribunal Video Platform. The following people were in attendance in addition to the two counsel specified below:

Ms Yasmin Barber - Gannons Solicitors

Ms Emily Kivell – Officer of the Respondents;

Mr Stewart Day - director of the Appellant (for part)

A face to face hearing was not held because of the COVID 19 pandemic and because the matters at issue were considered appropriate to be dealt with by way of a video hearing.

The documents to which I was referred included various bundles – a documents bundle (including an associated index) of 99 pages and an authorities bundle (including associated index) of 372 pages. Together, these contained the submissions, legislation and case law relevant to the hearing.

Mr Howard Watkinson, counsel, instructed by Gannons Solicitors, for the Appellants
Mr Joseph Millington, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This decision relates to:

   (1) an application by the Appellant, under Rule 8(3)(c) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the "Tribunal Rules"), as it applies pursuant to Rule 8(7) of the Tribunal Rules, for the Respondents to be barred from taking further part in the above appeal (because there is no reasonable prospect of the Respondents' case succeeding);

   (2) a related application by the Appellant, under Rule 8(8) of the Tribunal Rules, for the appeal to be determined in the Appellant's favour; and

   (3) an application by the Respondents to amend their original statement of case dated 16 March 2020, in the form set out in Appendix 1 hereto (the "SOC") in the manner set out in an amended statement of case, in the form set out in Appendix 2 hereto (the "ASOC").

BACKGROUND

2. The subject of the underlying appeal may be summarised briefly. In its VAT return for the 05/19 period, the Appellant claimed to deduct input tax in the aggregate amount of £78,000 in respect of two supplies which had been made to it by a related company, Westbridge Associates Limited ("Westbridge"). Mr Stewart Day was the director of both the Appellant and Westbridge and, at the time of the supplies in question, Westbridge had failed to comply with its obligations to account for output tax in respect of its supplies from the date of its registration, on 27 June 2017. The Respondents refused the Appellant's claim and it is that refusal, together with a related penalty assessment, which is the subject of the underlying appeal.

3. In connection with the appeal, the Respondents filed and served the SOC on or around 16 March 2020.

4. By a notice dated 26 March 2020, the Appellant made the applications which are described in paragraphs 1(1) and 1(2) above.

5. On 2 July 2020, the Respondents filed and served their response to those applications and, without prejudice to that response, an application to amend the SOC so that it took the form of the ASOC, which was attached to their application.

6. On 16 July 2020, the Appellant filed and served its reply to the Respondents' response and made further submissions.

MATTERS TO BE ADDRESSED

7. There are essentially three matters for me to consider in this decision, as follows:

   (1) was the SOC properly pleaded, such that the Respondents would have a reasonable prospect of succeeding in the underlying appeal were that appeal to proceed on the basis of the SOC?

   (2) should the Respondents' application to amend the SOC be allowed? and

   (3) if the answer to question in paragraph 7(2) above is in the affirmative, is the ASOC properly pleaded, such that the Respondents would have a reasonable prospect of succeeding in the underlying appeal were that appeal to proceed on the basis of the ASOC?

THE RELEVANT LAW

Introduction

8. There are three distinct areas of law the principles of which are pertinent to this decision, as follows:

(1) the law relating to the subject matter of the underlying appeal – in other words, the law upon which the underlying appeal, should it proceed to a hearing, will depend;

(2) the law relating to the form which pleadings in relation to fraud or dishonesty are required to take; and

(3) the law relating to the matters to be considered in relation to any application by a party in litigation to amend its pleadings.

9. The reason why all three areas are relevant is that, unless the SOC or, as the case may be, the ASOC reveal that the Respondents have a reasonable prospect of succeeding in relation to the underlying appeal, the Appellant's applications must succeed and, before I can decide which of the SOC or the ASOC is relevant for that purpose, I need to decide whether to uphold the Respondents' application to amend the SOC in the form of the ASOC.

10. As for determining what amounts to a reasonable prospect of success in this context, the Upper Tribunal provided some guidance in *The Commissioners for Her Majesty's Revenue and Customs v Fairford Group plc and another* [2014] UKUT 329 (TCC) ("*Fairford*") as follows:

"[41] In our judgment an application to strike out in the FTT under r 8(3)(c) should be considered in a similar way to an application under CPR 3.4 in civil proceedings (whilst recognising that there is no equivalent jurisdiction in the FTT Rules to summary judgment under Pt 24). The tribunal must consider whether there is a realistic, as opposed to a fanciful (in the sense of it being entirely without substance), prospect of succeeding on the issue at a full hearing, see *Swain v Hillman* [2001] 1 All ER 91 and *Three Rivers* [2000] 3 All ER 1 at [95], [2003] 2 AC 1 per Lord Hope of Craighead. A 'realistic' prospect of success is one that carries some degree of conviction and not one that is merely arguable, see *ED & F Man Liquid Products Ltd v Pate*l [2003] EWCA Civ 472, [2003] 24 LS Gaz R 37. The tribunal must avoid conducting a 'mini-trial'. As Lord Hope observed in *Three Rivers*, the strike-out procedure is to deal with cases that are not fit for a full hearing at all."

11. Thus, I am required to consider what matters the Respondents need to establish in order to succeed in their appeal and whether or not the SOC properly pleaded (or the ASOC properly pleads, as the case may be) the primary facts which, if subsequently proved at the hearing of the substantive appeal, will establish that.

The subject matter of the underlying appeal

12. The right to deduct VAT input tax arises at the time when the input tax becomes chargeable (see Article 167 of Council Directive 2006/112/EC (the "Directive")). However, that right does not arise, and any input tax previously credited by the national tax authority can be reclaimed, if:

(1) the right to deduct was being relied upon for fraudulent or abusive ends; or

(2) the transaction to which the input tax relates was connected with the fraudulent evasion of VAT and, by his purchase of the relevant supply, the Appellant knew or ought to have known of that fact.

13. These exceptions have been the subject of decisions by the European Court of Justice (the "ECJ"), two of which are of particular relevance to this decision.

14. In *I/S Fini H v Skatteministeriet* (C-32/03) ("*Fini*"), the ECJ held that a right to deduct cannot be relied upon for fraudulent or abusive ends and that it is a matter for the national court to determine whether this is the case whilst, in *Axel Kittel v Belgian State & Belgian State v Recolta Recycling SPRL* (C-439/04 and C-440/04) ("*Kittel*"), the ECJ held that a taxable person who knows or should know that, by his purchase, he is taking part in a transaction connected with the fraudulent evasion of VAT must be regarded for the purposes of VAT law as a participant in that fraud because, in such a situation, the taxable person aids the perpetrators of the fraud and becomes their accomplice.

15. In *Fini*, the relevant taxpayer claimed to be able to recover input tax which it incurred in paying rent and other charges in relation to its business premises after ceasing to carry on its business. The ECJ held that the taxpayer was entitled to do so unless the national court were to determine that it was doing so for fraudulent or abusive ends - for example, if the national court determined that the taxpayer was continuing to use the premises for purely private purposes after the business ceased.

16. In *Kittel*, the ECJ held that the national court should refuse the right to deduct input tax where the taxable person claiming the input tax, by his purchase, knew or should have known that the supply giving rise to the input tax was connected to fraud but that, in the absence of such actual or constructive knowledge of the fraud by the claimant, the right to deduct remained intact notwithstanding that it was connected with fraud by the supplier or by a person higher up the supply chain.

17. In its decision in *Kittel*, the ECJ clearly saw situations where the claimant had had actual or constructive knowledge of the fraud by its supplier or by a person higher up the supply chain as an extension of the principle which was applicable in *Fini*. In other words, just as a fraud by the taxable person himself would mean that the objective criteria for the input tax to be recoverable would not be satisfied – as was mentioned in *Fini* – a taxable person who knew or should have known of fraud by his supplier or by a person higher up the supply chain became an accomplice of the fraudster and therefore should be regarded as a participant in that fraud – see *Kittel* at paragraphs [49] to [61] and the commentary on that paragraph by Moses LJ at paragraphs [41] to [44] in *Mobilx Limited (in Administration), The Commissioners for Her Majesty's Revenue and Customs, Calltel Limited & another v The Commissioners for Her Majesty's Revenue and Customs, Blue Sphere Global Limited, The Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517 ("*Mobilx*"). A key point in this regard is that the taxable person's actual or constructive knowledge of the fraud would deprive the transaction of the status of being a taxable supply because the objective criteria for being such a taxable supply were not met – see Moses LJ at paragraphs [28] and [45] to [49] in *Mobilx*.

Pleadings

18. I will not go into great detail in relation to the law which is relevant to pleading because it is largely common ground. The principles may be summarised as follows:

> (1) fraud or dishonesty must be distinctly alleged and distinctly proved. This means that a party alleging fraud or dishonesty must both plead that the other party has committed fraud or been dishonest and plead the primary facts on which the first-mentioned party will rely to show that the other party was acting fraudulently or being dishonest;
>
> (2) primary facts which are consistent with honesty are insufficient but the primary facts on which reliance is placed do not need to be exclusively consistent with fraud or dishonesty. It is sufficient that there is some fact which tilts the balance and justifies an

inference of fraud or dishonesty. In other words, the correct test is whether, on the basis of the primary facts, an inference of fraud or dishonesty is more likely;

(3) statements of case should be concise and avoid excessive detail but they must still be sufficiently accurate to identify the relevant issues for the court and the parties. The court and the parties should not have to dig behind what is pleaded to detect what is being alleged;

(4) there is nothing impermissible in advancing a plea of fraud or dishonesty in the alternative to a plea involving lesser culpability; and

(5) in an action to strike out the case of a party who has alleged fraud or dishonesty, the court should not be concerned with the question of whether the evidence at trial will or will not establish fraud or dishonesty but only with whether the facts pleaded, if established at trial, would justify the plea of fraud or dishonesty. The focus in that event must be on the pleadings and not on the strength of the evidence and the court must simply assume the truth of the pleaded case.

19. The above principles can be seen in a number of cases, including *Three Rivers District Council v Bank of England* [2001] UKHL 16, *Gamatronic (UK) Limited & another v Hamilton* [2013] EWHC 3287 (QB), *JSC Bank of Moscow v Kekhman and others* [2015] EWHC 3073 (Comm) and *Tejani v Fitzroy Place Residential Limited* [2020] EWHC 1856 (TCC). The principles are as applicable to cases before this Tribunal as they are to civil proceedings before the High Court (see *The Commissioners for Her Majesty's Revenue and Customs v Citibank NA, E Buyer UK Limited* [2017] EWCA 1416 (Civ) ("*Citibank*")).

Amendment of pleadings

20. As regards the principles applicable to the amendment of pleadings, Carr J in *Qua Su-Ling v Goldman Sachs International* [2015] EWHC 759 (Comm) noted that "[whether] to allow an amendment is a matter for the discretion of the court. In exercising that discretion, the overriding objective is of the greatest importance. Applications always involve the court striking a balance between injustice to the applicant if the amendment is refused, and injustice to the opposing party and other litigants in general, if the amendment is permitted" and this was echoed by Pepperall J in *Essex County Council v UBB Waste (Essex) Limited* [2019] EWHC 819 (TC) ("*UBB Waste*"), as follows:

"In my judgment, there is essentially one rule on any application to amend. Parties should be allowed to amend their statements of case to bring forward intelligible and apparently credible claims or defences where the balance of injustice to the applicant if the amendment is refused outweighs the injustice to the other party and to litigants in general if the amendment is permitted."

SUBMISSIONS

Introduction

21. I now turn to the submissions of the parties.

22. As I have flagged in paragraph 8 above, these submissions involve a mixture of:

(1) submissions relating to the matters which the Respondents must establish to succeed in their appeal;

(2) submissions relating to whether or not the SOC properly pleaded (or the ASOC properly pleads, as the case may be) the primary facts which, if subsequently proved at the hearing of the underlying appeal, will enable the Respondents to succeed in relation to the underlying appeal; and

(3) submissions relating to whether or not the Respondents should be permitted to amend the SOC in the form of the ASOC.

The matters which need to be established

The different types of denial

23. Mr Watkinson, on behalf of the Appellant, submitted that the Respondents' challenge to the Appellant's input tax claim could essentially be broken down into four distinct limbs as follows:

(1) a challenge on the basis that the claim was abusive;

(2) a challenge on the basis that the claim was fraudulent;

(3) a challenge on the basis that the Appellant knew that the supply was connected with the fraudulent evasion of VAT; and

(4) a challenge on the basis that the Appellant should have known that the supply was connected with the fraudulent evasion of VAT.

24. In Mr Watkinson's view, a challenge based on an allegation that the input tax sought to be recovered arose in an abusive transaction was to be distinguished from a challenge based on an allegation that the input tax sought to be recovered arose in a fraudulent transaction. The first type of challenge related to circumstances where the facts were not in dispute but the question at issue was whether the relevant law properly applied to those facts. In contrast, the second type of challenge related to misrepresentations where the question at issue was whether the facts to which the relevant law was being applied corresponded to reality. Whereas the decision in *Halifax plc v Customs and Excise Commissioners* (Case C-255/02) ("*Halifax*") was an example of the first type of challenge, the decision in *Fini* was an example of the second. In support of this distinction, Mr Watkinson provided me with an extract from a text book written by a respected practitioner in European Union law entitled "Abuse of EU Law and Regulation of the Internal Market, Saydé (Hart, 2016)".

25. Mr Watkinson said that, similarly, a challenge based on an allegation that the taxpayer in question knew that the relevant supply was connected with the fraudulent evasion of VAT was to be distinguished from a challenge based on an allegation that the taxpayer in question ought to have known that fact. The former depended on the actual knowledge of the claimant at the time when the input tax became chargeable whereas the latter depended on what the claimant should have known at the time when the input tax became chargeable.

26. Mr Millington, on behalf of the Respondents, accepted that the Respondents were not advancing:

(1) any case on "abuse" as that concept was applied in *Halifax*; and

(2) any case on constructive knowledge in relation to the *Kittel* principle.

27. However, he did not accept that the term "fraudulent" – which was the applicable term in relation to the Respondents' challenge under *Fini* - should be limited in the way suggested by Mr Watkinson. He pointed out that, although *Fini* itself was concerned with a fraud involving misrepresentation, there was no suggestion in *Fini* itself (or indeed any other case law authority) for the proposition that fraud in a VAT context could arise only where there was a misrepresentation to the national tax authorities.

28. In support of that proposition, he cited the language in paragraphs [32] and [34] of *Fini*, which were expressed in general terms and made it clear that misrepresentation was just one example of a situation where European Union law was being used for abusive or fraudulent ends. He added that, if fraud in the VAT context was limited to fraud involving

misrepresentation to the national tax authorities, then it would never be possible to prove fraud against the recipient of a supply in a *Kittel* case, which was contrary to the very basis of the litigation in *Citibank*.

29. Finally, he said that, even if he was wrong and *Fini* was confined to fraud based on misrepresentation, that limitation was a matter to be determined at the hearing of the underlying appeal after full argument on the point and not at this stage in the proceedings.

Kittel - timing

30. The parties also disagreed on the time at which the state of a claimant's knowledge needed to be determined for the purposes of applying *Kittel*.

31. Mr Watkinson said that it was clear, from both the decision in *Kittel* and the analysis of the relevant principles by Moses LJ in *Mobilx*, that the actual or constructive knowledge of the claimant had to be determined at the point in time when the right to deduct the relevant input tax would otherwise arise because it was at that point that the recipient needed to know whether the supply in question satisfied the objective criteria which had to be met before that right arose- see the comments of Moses LJ in this regard at paragraph [65] in *Mobilx*. Article 167 of the Directive stipulated that the right to deduct arose when "the deductible tax became chargeable" and the ECJ in *Kittel* had held that "[the] right to deduct is exercisable immediately in respect of all the taxes charged on transactions relating to inputs" (see paragraph [47] in *Kittel*). It must follow that the state of knowledge of the recipient had to be determined at the point at which the relevant input tax became chargeable.

32. Mr Millington said that that was not invariably the case. He submitted that, whilst that might be the case in the context of a classic missing trader intra-community ("MTIC") appeal, it was common ground that the underlying appeal in this case was not a classic MTIC appeal. In the underlying appeal in this case, the Respondents were challenging an input tax claim on *Kittel* grounds in circumstances where the supplier and the claimant had a common director and the output tax in relation to the supply in respect of which the input tax was being claimed had not been paid. He said that, in those circumstances, he did not accept that the only relevant time for determining whether actual knowledge of a fraud existed was the time when the relevant input tax became chargeable.

33. In support of his position, Mr Millington cited two decisions by the First-tier Tribunal – *Medallion Europe Limited v The Commissioners for Her Majesty's Revenue and Customs* [2015] UKFTT 0406 (TC) (*Medallion*") and *Victoria Walk Limited v The Commissioners for Her Majesty's Revenue and Customs* [2016] UKFTT 0687 (TC) ("*Victoria Walk*"). He said that these showed that the timing question was more complicated in those situations.

34. In *Medallion*, the relevant First-tier Tribunal had not expressly addressed the question of timing and its approach instead was to consider the integrity of the relevant sole director more generally in the context of the ongoing supplies and the events which unfolded.

35. In contrast, the First-tier Tribunal in *Victoria Walk* did address this question head-on in paragraphs [104] et seq. of the decision. Its conclusion was that, whilst, in a classic MTIC situation, where there was typically no connection between the supplier and recipient of the supply other than the series of transactions in which they were both involved, it was appropriate to require actual or constructive knowledge of the fraud to exist at the time when the input tax became chargeable, it was not appropriate to adopt that standard in a situation such as the one in that case (and in the underlying appeal in this case), where the two parties to the transaction in question were controlled by the same person and therefore the state of mind of that person was determinative of the motives and intentions of both the supplier and the recipient of the supply. This was because the *Kittel* principle was no more than an

extension of the basic principle that a person who is engaged in fraud cannot establish that the objective criteria which determine the scope of VAT and the right to deduct input tax have been met. The First-tier Tribunal in *Victoria Walk* went on:

"113. The statements of that principle (in Mobilx and Kittel) are referring to persons who, absent the extension of the basic principle, would otherwise be entitled to claim to recover the input tax. Where the two parties to the transaction in question are intimately connected – as in this case, where HPL and VWL are both ultimately owned by the same person and have the same director – the knowledge and motives of one cannot sensibly be distinguished from the other. If at any stage in the transactions or their reporting, one of them is engaged in conduct which would be regarded as the fraudulent evasion of VAT (which might vitiate its rights under the VAT system), the other must equally be regarded as being so engaged. That is not so much an application of the Kittel extension to the basic principle, but of the basic principle itself."

36. Mr Millington accepted that both *Medallion* and *Victoria Walk*, as first instance decisions, were not binding upon me. However, he added that, whatever my personal views on this question might be, those two cases showed that this was a developing area of the law and that, in an interlocutory hearing such as the one to which this decision relates, it would be inappropriate for me to rule out this approach by acceding to the Appellant's application on the basis that the two cases were wrongly decided. This was a matter to be decided at the hearing of the underlying appeal.

37. Mr Watkinson submitted that the focus in both *Medallion* and *Victoria Walk* was solely on the question of whether there had been fraud by the supplier – that is to say, one of the preliminary issues in any denial, based on *Kittel*, of an input tax claim by the recipient of the supply. The knowledge of the recipient of the supply was assumed. He pointed to paragraphs [83] and [104] in this respect.

The SOC and the ASOC

General

38. Mr Watkinson submitted that, on the basis that, by Mr Millington's own admission, the Respondents were not advancing any arguments in the SOC or the ASOC to the effect that there had been an abusive transaction of the *Halifax* type or that the Appellant had had constructive knowledge of the fraud by Westbridge, the first and fourth categories of case described in paragraph 23 above were wholly irrelevant to the underlying appeal in this case.

39. Mr Watkinson therefore claimed that, at the very least, even if the present applications by the Appellant failed, I should direct that all allegations in the SOC or, as the case may be, the ASOC, to the effect that the present situation fell within the first or fourth category of the categories of case set out in paragraph 23 above should be struck out. For the same reason, the paragraphs in the SOC and the ASOC which outlined at some length the law in relation to constructive knowledge – paragraphs [28], [31] and [35] in the SOC and paragraphs [35], [38] and [42] of the ASOC – were otiose because no allegation of constructive knowledge was being advanced by the Respondents. Accordingly, even if the Appellant's applications failed, the SOC or, as the case may be, the ASOC needed to be amended so that those paragraphs were struck out.

40. Mr Millington did not demur from Mr Watkinson in relation to this. He accepted that the Respondents were not alleging abuse of the *Halifax* kind and that, as regards their *Kittel* challenge, the fact that Mr Day was the director of both companies meant that any denial of input tax based on *Kittel* must inevitably be based on actual, and not constructive, knowledge.

41. Turning then to the second and third categories of case set out in paragraph 23 above, Mr Watkinson said that neither the SOC nor the ASOC properly pleaded the primary facts necessary to support those allegations.

42. He said as follows in relation to both documents:

(1) there was no need for the Respondents to have pleaded *Fini* fraud by the Appellant when it was sufficient for them to succeed in the appeal in reliance on *Kittel* actual knowledge by the Appellant. As Birss J had observed in *Property Alliance Group v Royal Bank of Scotland* [2015] EWHC 3272 (Ch), "allegations of fraud can cause a major increase in the cost, complexity and temperature of an action" and therefore a party should be reticent before pleading it. In this case, a successful plea to the effect that there had been fraud by Westbridge and that the Appellant had had actual knowledge of that fraud would have been sufficient in and of itself to justify both the denial of the input tax claim and the related penalty. I should therefore be particularly astute to ensure that any allegation of *Fini* fraud by the Appellant was properly made;

(2) in that regard, at no point in the SOC or the ASOC did the Respondents allege that:

(a) the transactions in respect of which the input tax was incurred did not in fact occur, did not take place wholly for business purposes or did not take place in the manner in which the documents said they did;

(b) any of the documents supporting the claim was a sham; or

(c) any of the invoices was invalid for VAT purposes;

(3) instead, the Respondents' case on the Appellant's *Fini* fraud appeared to be no more than that the Appellant knew that Westbridge had not accounted for the output tax in respect of which the supplies to which the input tax claimed by the Appellant related and that Westbridge's failure was fraudulent. That, if it were properly pleaded, would be a fraud by Westbridge of which the Appellant had actual knowledge. It would not be a fraud by the Appellant. It could be seen from the decision of Millett LJ in *Paragon Finance v Thakerar* [1998] EWCA Civ 1249, [1999] 1 All ER 400 ("*Thakerer*") that pleading that a person had knowledge of another person's fraud was not, in and of itself, a pleading of fraud by the first-mentioned person. Millett LJ said:

"An allegation that the defendant had actual knowledge of the existence of a fraud perpetrated by others and failed to disclose the fact to the victim is consistent with an inadvertent failure to make disclosure and is not a charge of fraud. It will not support a finding of fraud even if the Court is satisfied that the failure to disclose was deliberate and dishonest. Where it is expressly alleged that such failure was negligent and in breach of a contractual obligation of disclosure, but not that it was deliberate and dishonest, there is no room for treating it as an allegation of fraud";

(4) similarly, in *Citibank*, the Court of Appeal had held that the Respondents did not need to plead fraud in order to succeed in an allegation of actual knowledge by a taxable person of another person's fraud. It was odd, to say the least, that, after litigating for many years to establish that an allegation of actual knowledge of another person's fraud did not necessarily involve an allegation of dishonesty against the person with actual knowledge (in *Citibank*), the Respondents were now saying in this case that the Appellant's actual knowledge of Westbridge's fraud meant that the Appellant too was dishonest;

(5) moreover, as outlined in paragraph 24 above, this was not a case which actually fell within the *Fini* fraud category because there had been no misrepresentation by the

Appellant. Merely knowing that Westbridge was not going to account for its output tax did not involve a misrepresentation by the Appellant as to the fact that the input tax had been incurred, the relevant transactions had occurred and the right to credit for the input tax arose; and

(6) the VAT legislation permitted the recipient of a supply to defer paying all or any part of the consideration for a supply for the period of six months following the date of the supply (or, if later, the date when the consideration for the supply became payable) because it denied a credit for input tax only to the extent that the input tax related to the part of the consideration which was unpaid at the end of that six month period – see Section 26A of the Value Added Tax Act 1994 (the "VATA"). It followed that any suggestion by the Respondents to the effect that a failure by the Appellant to have paid Westbridge the full amount shown on the invoices in question by the time that the Appellant claimed to recover its input tax in respect of the relevant supplies was indicative of fraud was unsustainable.

43. In response, Mr Millington said that:

(1) just because *Citibank* had established that it was unnecessary for the Respondents to plead fraud in a case in which they were pleading actual knowledge did not mean that it was impermissible for the Respondents to plead fraud in an appropriate case. This was such a case;

(2) on facts such as these, where the same person was director of both the defaulting supplier and the input tax claimant, it would be artificial to suggest that the relevant fraud had been perpetrated by the supplier and not also by the claimant. Thus, the general statement by Millett LJ in *Thakerer* set out in paragraph 42(3) above was not applicable in these circumstances; and

(3) as mentioned in paragraphs 27 to 29 above, there was no suggestion in the relevant case law to suggest that a claimant could be guilty of fraud only if it made a misrepresentation as to facts. It was perfectly possible for a claimant to commit fraud in other ways.

The SOC – detailed submissions

44. Mr Watkinson went on to say that, as for the details of the SOC:

(1) the Respondents had failed in paragraph [40] adequately to distinguish between the first two categories of case set out in paragraph 23 above and had not made it clear which primary facts set out in paragraph [41] related to which category of case;

(2) there was simply a gallimaufry of unparticularised facts set out in paragraph [41], and those facts were admitted in that paragraph to be consistent with both innocence and fraud;

(3) the facts set out in paragraph [41] were insufficient to support an allegation of *Fini* fraud by the Appellant. Paragraph [41a] was simply a statement that, as Westbridge and the Appellant had a common director and shareholder, it could be inferred that each company must have acted in full knowledge of the other, paragraphs [41b] to [41h] then described the cash flow problem alleged by the Appellant in its grounds of appeal to be the reason for Westbridge's failure to account for output tax and said that that reason was not credible, paragraph [41i] accepted that the fees paid by the Appellant to Westbridge were commercial in nature but alleged that this did not affect the conclusion that the transactions in question were undertaken for fraudulent or

abusive ends and paragraph [41j] merely repeated the allegation in paragraph [40] to the effect that the Appellant's input tax claim was for fraudulent and abusive ends;

(4) it was insufficient in this context merely to repeat the Appellant's grounds of appeal and say that the reason given in those grounds for Westbridge's default wasn't credible. Instead, there needed to be an express statement of the positive facts on which the Respondents would rely at the hearing in order to show that the claim by the Appellant was for fraudulent or abusive ends;

(5) there were similar deficiencies in paragraphs [42] and [43]. In the first place, those paragraphs purported to deal with the third and fourth category of case set out in paragraph 23 above whereas, as noted in paragraph 40 above, Mr Millington had accepted that the Respondents were not alleging that the Appellant had constructive knowledge of Westbridge's fraud and the SOC did not contain any facts to support a claim of constructive, as opposed to actual, knowledge. In the second place, paragraph [43] purported to rely on the same facts and inferences as had been set out in paragraph [41] to support the allegation of actual knowledge of the fraudulent evasion of VAT and, as noted in paragraph 44(3) above, paragraph [41] did no such thing; and

(6) the SOC contained no plea to the effect that Mr Day had been dishonest in relation to Westbridge's position or to the effect that he had had the requisite state of mind for the Appellant's claim to fall within the third category of case set out in paragraph 23 above. In the absence of those pleas, it was impossible for the Respondents to succeed in denying the Appellant's claim on the *Kittel* basis – that is, that the Appellant had had actual knowledge of a fraud by Westbridge.

45. Mr Millington replied that the relevant paragraphs of the SOC complied with the rules on pleading described in paragraph 18 above because they set out the primary facts on which the Respondents intended to rely to demonstrate that the Appellant both knew of the fraud committed by Westbridge and had itself committed fraud. The Respondents position – which was that the Appellant knew that Westbridge was going to act fraudulently in failing to account for output tax on the supplies to which the input tax claimed by the Appellant related and that, in possessing that knowledge, the Appellant had acted fraudulently itself – was clearly set out in paragraph [41] of the SOC. That paragraph set out all of the primary facts from which the inference could be drawn that such knowledge and fraudulent activity existed and on which the Respondents would seek to rely in pursuing its case.

The ASOC – detailed submissions

46. In relation to the details of the ASOC, Mr Watkinson submitted that:

(1) the use of the word "purportedly" in each of paragraphs [14a] and [14b] was unjustified and inconsistent with the rest of the document as at no stage had the Respondents questioned the fact that the supplies which were described on the invoices had actually occurred in the manner so described and were genuine;

(2) as for the allegations against the Appellant, it could be seen that paragraphs [52] to [56] of the ASOC related to the Respondents' claim against the Appellant of *Kittel* actual knowledge, whilst paragraphs [57] and [58] related to the Respondents' claim against the Appellant of *Fini* fraud;

(3) the pleading in paragraphs [52] to [56] in relation to *Kittel* actual knowledge was defective in that:

(a) paragraph [52] cited, as a factor which was relevant to the Appellant's actual knowledge of Westbridge's fraud, Mr Day's actual knowledge that

Westbridge had failed to account for any output tax on the invoices as at the date when the invoices were issued. However, as a matter of VAT law, it was not necessary for a supplier to account for output tax in respect of a supply on the date that it issued invoices in relation to that supply. Instead, the supplier was not required to account for output tax until after the end of the VAT period in which the relevant supply took place;

(b) paragraphs [53] and [54] were both said to be based on the state of Mr Day's knowledge as at the date when the Appellant submitted its return in respect of the 05/19 VAT period and made its claim for the input tax whereas it was clear from the decision in *Mobilx* that the relevant time for considering the actual or constructive knowledge of the claimant was the time when the input tax became chargeable and not the time when the credit for the input tax was claimed. Thus, the claims made in those paragraphs of the ASOC were defective; and

(c) paragraph [55] was flawed for the same reason as the plea by the Respondents in paragraph [41] in the SOC. It amounted to no more than an assertion that the Respondents did not believe the Appellant's explanation that Westbridge's default was attributable to a cash flow problem. It was not a positive statement of fact which, if proved, would justify the allegation of fraud by Westbridge and knowledge of that fraud by the Appellant; and

(4) the pleading in paragraphs [57] and [58] in relation to *Fini* fraud was also defective in that, as outlined in paragraph 42(5) above, actual knowledge of fraud by another did not amount to *Fini* fraud. Instead, the latter required there to be some form of fraudulent misrepresentation by the claimant, such as claiming input tax in relation to supplies received for private use, and, in this case, no such allegation was being made.

47. In response, Mr Millington said that Mr Watkinson's reading of the ASOC was misconceived in that Mr Watkinson had failed to take into account the way in which paragraphs [47] to [58] had been set out. This had led Mr Watkinson to misconstrue the ASOC. More specifically:

(1) there was a heading entitled "RESPONDENTS' CASE" before paragraph [47] to indicate that the Respondents were about to set out their case;

(2) there then followed, in paragraphs [47] to [51], the primary facts relating to Westbridge on which the Respondents would seek to rely when it came to making their allegations. This approach was indicated by the sub-heading "Westbridge" which immediately preceded paragraph [47];

(3) paragraphs [52] to [55] then set out the primary facts relating to the Appellant on which the Respondents would seek to rely when it came to making their allegations. This approach was indicated by the sub-heading "The Appellant" which immediately preceded paragraph [52];

(4) paragraphs [56] to [58] then set out the legal principles on which, on the basis of the primary facts alleged in relation to Westbridge in paragraphs [47] to [51] and the primary facts alleged in relation to the Appellant in paragraphs [52] to [55], the Respondents intended to rely to deny the Appellant's claim to the input tax. Those principles were, first, *Kittel* actual knowledge of Westbridge's fraud (paragraph [55]) and, secondly, in the alternative, *Fini* fraud by the Appellant (paragraphs [56] to [58]). That approach was flagged by the use of the heading "The Denial" just before paragraph [56] and the use of the words "In the circumstances" at the start of paragraph [56];

(5) as for the contention that paragraphs [53] and [54] were predicated on a time – the time when the 05/19 return was submitted and the claim for the input tax was made – which was the wrong time on which a challenge based on *Kittel* actual knowledge needed to be based:

(a) as noted in paragraphs 32 to 36 above, Mr Millington did not agree that, in a case involving the same person as director of both entities to the relevant transaction, the application of the *Kittel* test was limited to the time when the input tax became chargeable. At the very least, he submitted, the position was sufficiently unclear that these proceedings were not the appropriate time to test that question. It was apparent from the decisions in *Medallion* and *Victoria Walk* that a more flexible timing test was at the very least arguable and that the law in this area was in a state of flux. Accordingly, the Respondents should be entitled to proceed to the hearing of the underlying appeal where the arguments on both sides could be properly ventilated; and

(b) in any event, even if the time set out in paragraphs [53] and [54] was clearly incorrect, paragraph [52] referred to the position at the time at which the invoices in question were issued and paragraph [56] – the actual *Kittel* allegation – was neutral as to time; and

(6) as for the allegation by Mr Watkinson in paragraph 46(3)(a) above, the timing of the two supplies in this case was such that Westbridge was required by law to have accounted for output tax in respect of the first supply by the time that the invoice in relation to the second supply was issued and that meant that the relevant allegation was justified.

Amending the pleadings

48. Finally, in relation to the application by the Respondents to amend the SOC in the form of the ASOC, Mr Millington said that:

(1) although the Respondents' position was that the pleading in the SOC was sufficient in and of itself to support the Respondents' case, the Respondents had offered up an amended version of the SOC in order to clarify its position and demonstrate its desire to be helpful to, and co-operate with, the Appellant;

(2) in addition, the Respondents wished to provide further details in relation to the underlying facts because the SOC had been drafted on the basis that the statement in the Appellant's grounds of appeal to the effect that it had paid all but the VAT component of the consideration for the two supplies was not consistent with the facts as supplied to the Respondents by the Appellant's adviser, Mr Neil Day of Younique, in the course of 2019. Accordingly, the Respondents had taken the opportunity in the ASOC to describe the facts as they had been so presented and to note the inconsistency; and

(3) in any event, in terms of timing, the ASOC had been filed and served very shortly after the Appellant had made the applications which are the subject of this decision. The SOC was dated 16 March 2020. On 24 March 2020, a general stay on proceedings before the First-tier Tribunal in response to the COVID 19 crisis was announced. On 21 April 2020, that stay was extended until 30 June 2020 and the dates for compliance with all time limits were further extended by 70 days. The ASOC was filed and served on 2 July 2020. Accordingly, taking into account the stay, the delay between the filing and service of the SOC and the filing and service of the ASOC was minimal and, in any event, matters were still at an early stage in the proceedings. As noted by Carr J and Pepperall J in the extracts from the cases cited at paragraph 20 above, a party to

proceedings was permitted to amend its pleadings "where the balance of injustice to the applicant if the amendment is refused outweighs the injustice to the other party and to the litigants in general if the amendment is permitted". This was just such a case.

49. In response, Mr Watkinson said that it was unusual, to say the least, for a party to proceedings to maintain that its original pleading was sufficient while at the same time applying to amend that pleading. That amounted to having one's cake and eating it. The Respondents needed to pin their colours to one particular mast. He added that Mr Millington's description of the ASOC as merely containing "further and better particulars" of the Respondents' pleading was highly misleading, given that the ASOC was quite clearly a wholesale re-pleading of the Respondents' case.

CONCLUSIONS

Summary of conclusions

50. I have reflected on the various submissions set out above and, based on the reasons which are set out in the paragraphs which follow, my conclusions are that:

(1) there are some serious shortcomings in the SOC which mean that, were it not for the two conclusions in paragraphs 50(2) and 50(3) below, I would be inclined to accede to the Appellant's applications;

(2) however, I uphold the Respondents' application to file and serve the ASOC as a replacement to the SOC; and

(3) having done so, in my opinion:

(a) so far as the allegation in relation to *Fini* fraud is concerned, the ASOC is drafted in such a way as to comply with the law on pleadings summarised in paragraphs 18 and 19 above and, accordingly, the Appellant's applications are dismissed; but

(b) based on the drafting of the ASOC, the Respondents have no reasonable prospect of succeeding in relation to:

(i) the *Kittel* actual knowledge allegation which is set out in the ASOC; or

(ii) the penalty under Section 69C of the VATA

and therefore, in accordance with the terms of Rule 8, those parts of the Respondents' case are hereby struck out.

Reasons

Introduction

51. My reasons for reaching each of the above conclusions are set out in the paragraphs which follow.

52. However, before giving the reasons for my conclusions in relation to the three questions set out above, I should set out my conclusions in relation to the disputes between the parties as to the principles to be derived from the two cases which are at the heart of the Respondents' case in the underlying appeal – namely, *Fini* and *Kittel*.

53. As regards *Fini*, I have not been presented with any case law to suggest that the phrase "fraudulent…ends", as used at paragraph [32] in *Fini*, should be construed as being limited to frauds based on misrepresentation. On the contrary, the more natural reading of that paragraph and the three paragraphs which follow it is that any kind of fraud by the person

claiming the right to deduct the relevant input tax is sufficient to enable the national tax authority to deny the relevant input tax claim. Accordingly, notwithstanding the views which are expressed in the text book extract with which I was presented at the hearing, I can see no reason to debar the Respondents from proceeding to rely on *Fini* at the hearing of the underlying appeal provided that the *Fini* allegation and the primary facts to support that allegation have been appropriately pleaded, a matter which I address below. It seems to me that, if the Respondents are able to establish at that hearing that, based on all the evidence, the Appellant acted fraudulently in making its claim to recover the input tax knowing that Westbridge would not be accounting for the output tax corresponding to that input tax, then I can see no reason why they should not succeed in relation to the underlying appeal.

54. Expressing the position at its lowest, even if I am wrong in reaching that conclusion, the position on this point seems to me to be sufficiently arguable to conclude that the Respondents have a reasonable prospect of success in relation to this point in the underlying appeal.

55. I am much less convinced by the Respondents' position in relation to the time at which knowledge should be tested in applying *Kittel*.

56. I should start by saying that, whilst I agree with Mr Watkinson that:

(1) in both *Medallion* and *Victoria Walk*, the primary focus of the relevant First-tier Tribunal was on whether or not there had been fraud by the supplier; and

(2) the First-tier Tribunal in *Medallion* appears not to have considered or addressed the question of exactly when the actual knowledge which it assumed the claimant of the input tax had had arisen,

I do not agree that the timing question escaped the notice of the First-tier Tribunal in *Victoria Walk*. On the contrary, I think that the First-tier Tribunal at paragraphs [104] et seq. in *Victoria Walk* quite clearly confronted the question head-on. Therefore, I do think that Mr Millington was right in saying that *Victoria Walk* is authority, albeit not binding authority, for the proposition that the time at which the actual knowledge of the recipient of the supply is to be tested in a *Kittel* case is not invariably the time at which the supply was made.

57. However, notwithstanding that recognition, I do not agree with the conclusion which was reached on this point in *Victoria Walk* for the reasons which follow. In my view, the time at which *Kittel* actual knowledge is to be tested is the time when the input tax became chargeable because it is then that the question of whether the satisfaction of the objective criteria for the right to deduct the input tax must be tested.

58. The First-tier Tribunal in *Victoria Walk* accepted that the decisions in *Kittel* and *Mobilx* suggested that the relevant time at which the recipient of the supply had to have the requisite knowledge was "the time at which the transaction took place, being the time at which the right to recover the input tax arose" (see paragraph [106]). However, it went on to say that that timing limitation was appropriate only for conventional MTIC cases where the recipient of a supply had no connection to the supplier apart from the supply in question. The First-tier Tribunal concluded that, in a case where such a connection did exist, the existence of the connection meant that the knowledge and motives of one party to the supply could not sensibly be distinguished from the knowledge and motives of the other party to the supply and therefore, if, at any stage in the transaction or in its reporting, one of them was engaged in fraud that might vitiate its rights under the VAT system, then the other must equally be regarded as so engaged. The First-tier Tribunal concluded that "[that] is not so much an application of the Kittel extension to the basic principle, but of the basic principle itself."

59. While I am reluctant to disagree with the First-tier Tribunal in that case, it seems to me that, in the final sentence of its reasoning, when it recognised that it was applying the basic principle itself and not the *Kittel* extension to that basic principle, it overlooked the fact that a plea based on fraudulent intent arising after the time when the input tax became chargeable and the right to recover the input tax arose was in fact a plea based on the taxable person's own fraud, as in *Fini*, and not a plea based on actual knowledge of the supplier's fraud, as in *Kittel*. In other words, the First-tier Tribunal was saying no more than that, if the supplier in a transaction involving two connected parties is acting fraudulently, then so too must be the recipient of the supply because the recipient of the supply must know that and have the same fraudulent intent. But that is saying no more than that a taxable person who is himself fraudulent has no right to recover input tax.

60. I can see no reason why, in a situation where the supplier and the recipient of the supply are connected and the relevant fraudulent intent arises only after the time at which the input tax has become chargeable and the right to recover the input tax has arisen, the Respondents should be unable to challenge the input tax recovery claim by relying on the recipient's own fraud, as in *Fini*, as long as *Fini* and the primary facts to support the allegation based on *Fini* have been properly pleaded. But that is not the same as saying that the Respondents can rely on *Kittel* in those circumstances. It follows that I do not agree that the Respondents would be able to succeed in a pleading based on *Kittel* where the relevant fraudulent intent (and knowledge of that fraudulent intent) arose only after the time at which the input tax became chargeable and the right to recover the input tax arose. The appropriate challenge in such a case is under *Fini*.

61. I believe that the contrary view involves a failure to apply the distinction which the ECJ was drawing in *Kittel* at paragraphs [55] to [61] between:

> (1) a fraud by the taxable person himself at any time – which entitles the national tax authority to deny a claim for the relevant input tax; and
>
> (2) a fraud by some person other than the taxable person himself – which entitles the national tax authority to deny a claim for the relevant input tax only if, at the time when the input tax becomes chargeable, the taxable person had actual or constructive knowledge of the fraud.

62. In the latter case, as soon as the taxable person lacks the requisite actual or constructive knowledge of the fraud at the time when the input tax becomes chargeable, the objective criteria for the input tax to be recovered are met and the right to deduction arises and that right remains valid unless the taxable person subsequently seeks to rely on it for fraudulent ends – see *Kittel* at paragraphs [54] and [55] and *Mobilx* at paragraph [28]. At that point, as a result of the taxable person's own fraud, the objective criteria cease retrospectively to be met and the input tax ceases to be recoverable.

63. For completeness, I should add that:

> (1) it is by no means axiomatic that, in a case involving a supply between connected persons, the fraudulent intent of the supplier (and hence the actual knowledge of that fraudulent intent by the recipient of the supply) will not exist at the point when the input tax became chargeable and the right to recover the input tax would otherwise arise. It is perfectly possible that, in a particular case, that fraudulent intent (and actual knowledge) will exist at that point and, in such a case, a plea based on *Kittel* actual knowledge in addition to a *Fini* fraud plea would be perfectly appropriate. However, where that fraudulent intent (and actual knowledge) arise only after that point, I consider that a plea based on *Kittel* is bound to fail;

(2) the question of precisely when the actual or constructive knowledge of fraud needs to exist in order for the right to deduct input tax to be denied is a different question from when the fraud in question needs to occur or have occurred. I am not suggesting that the fact that the recipient's actual or constructive knowledge of the fraud needs to exist at the time when the input tax becomes chargeable means that the fraud itself needs to have occurred by that time. It is perfectly possible for the fraud to be one which is going to occur "downstream" of the recipient and therefore necessarily at a time falling after the time when the input tax becomes chargeable. As long as the recipient has actual or constructive knowledge of that future fraud at the time when the input tax becomes chargeable, then a plea based on *Kittel* is still soundly-based (see *Bonik EOOD v Direktor na Direktsia 'Obzhalvane I upravlenie na izpalnenieto – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-285/11)at paragraphs [23(5)(c)] and [40] to [45]); and

(3) support for my conclusion on the time at which the requisite knowledge must exist in order to found a denial based on *Kittel* may be seen in this description of the decision of the ECJ in 2013 in the case of *Hardimpex*, by Arden LJ in *Fonecomp v The Commissioners of Her Majesty's Revenue and Customs* [2015] EWCA Civ 39, a case relating to contra-trading:

"Mr Lasok places much reliance on the decision of the CJEU on 16 May 2013 in *Hardimpex*. In this case the national legislation required a trader, who was seeking to deduct VAT, to have appropriate documentation for upstream transactions, which in the instant case appeared to include a transaction for which the import had been in breach of "disclosure and tax obligations". The question referred by the tax authorities was whether this national legislation was compatible with the right to deduct in the VAT Directive. The CJEU made it clear that the trader's inability to deduct would depend on the competent authorities' decision on whether he knew or ought to have known, at the time he entered into the transaction for which he claimed the right to deduct [my emphasis], of the fraud committed by the supplier or another party involved upstream or downstream in the supply chain. (HMRC contends that it is not necessary that the fraud should be a VAT fraud). This case appears to add nothing to the principles already established in *Kittel*."

64. It follows from the above that, in a situation such as the present one, where the same person is the sole director of both the supplier and the recipient of the supply, the state of mind of that director at the time when the input tax becomes chargeable needs to be ascertained and, if the requisite fraudulent intent existed at that time, the Respondents can deny a credit for that input tax in reliance on both *Fini* and *Kittel*, whereas, if the requisite fraudulent intent arises only after that time, the Respondents are limited to relying on *Fini* in order to deny a credit for that input tax.

65. In the light of the above conclusion and my construction of the ASOC in paragraphs 80 to 83 below, it is unnecessary for me to speculate in this decision on the precise time at which the input tax in this case did become chargeable. There are detailed rules in relation to times of supply in both the Directive and the VATA and the facts in this case are somewhat complicated in that, in relation to each supply, the performance of the service, payment for the service and delivery of the invoice for the service appear to have occurred at different times. Instead, it suffices for me to note at this point that, in relation to each supply which is relevant in the underlying appeal in this case, whenever the time at which the input tax became chargeable may have been, that time will have preceded the date when the Appellant submitted its claim for the repayment of the input tax in its 05/19 return because, by definition, a claim to deduct input tax cannot be made until the input tax has become chargeable, as there is no right of deduction until that time. (For completeness, I should also make it clear that the time at which VAT becomes chargeable is determined by the rules

governing the time of supply for VAT purposes; the ability to defer the payment of the consideration for a supply in the manner envisaged by Section 26A of the VATA is a quite separate matter and does not affect the date when the input tax "becomes chargeable", as is made clear by Article 62 of the Directive and is reflected in the language of Sections 25(2) and 26 of the VATA and Section 26A of the VATA itself.)

66. The conclusions set out in paragraphs 53 to 65 above inform the analysis which follows in relation to the SOC and ASOC.

The SOC

67. Turning now to the drafting of the SOC, my concerns about the SOC largely stem from paragraph [41] of the SOC.

68. After making the allegation in paragraph [40] of the SOC to the effect that the Appellant had relied upon the right to deduct input tax for "fraudulent…ends", it was imperative that the Respondents then set out, in positive terms, the primary facts on which they intended to rely at the hearing of the underlying appeal, in order to establish the veracity of that allegation.

69. However, when one looks at paragraph [41], it is conspicuous that most of the paragraphs are directed at expressing the Respondents' incredulity over the reasons given by the Appellant for the cash flow problem which the Appellant had alleged in its grounds of appeal. Paragraphs [41b] to [41g] do no more than recite the arguments provided by the Appellant and say that those arguments are not credible. Paragraph [41i] is also not a positive statement of primary facts which would justify the plea in paragraph [40]. That paragraph does no more than say that the Respondents' acceptance that the fees in question were standard commercial fees did not affect the Respondents' conclusion in paragraph [40] that the transactions were undertaken for "fraudulent …ends". Likewise, paragraph [41j] is simply a restatement of the assertion in paragraph [40].

70. The only two paragraphs in paragraph [41] which contain any positive statements on the part of the Respondents are paragraph [41a] – which states that it can be inferred that each of the Appellant and Westbridge must have acted in full knowledge of the other because of their common shareholder and director – and paragraph [41h] – which states that it can be inferred "from all the circumstances of the case" that the Appellant had deliberately underpaid Westbridge in the knowledge that Westbridge would not then pay the output tax. It is unclear what those circumstances are other than that the reasons given by the Appellant for Westbridge's default are not accepted.

71. What the Respondents needed to do in paragraph [41] of the SOC was to make positive statements of the primary facts on which it would rely to establish *Fini* fraud, as it has now in fact done in paragraph [57] of the ASOC. The statements in paragraphs [41a] and [41h] are not sufficiently particularised to set out the primary facts on which the Respondents intend to rely in order to prove their allegation of fraud.

72. There are similar problems with paragraph [43] in relation to the *Kittel* actual knowledge allegation in paragraph [42]. In particular:

(1) Westbridge's failure to account for the relevant output tax – which is mentioned in paragraph [43a] - is not of itself an indication of Westbridge's fraud; and

(2) for the reasons which I have set out in paragraphs 69 to 71 above, paragraph [41], which is cross-referenced in paragraph [43b] and upon which the Respondents rely to establish their allegation of Westbridge's fraud, does not contain positive and

particularised statements of the primary facts upon which the Respondents intend to rely to support that allegation.

73. In short, the onus to prove both the Appellant's fraud and Westbridge's fraud is on the Respondents as the party making the allegations and I do not consider that the terms of the SOC meet the standard which the case law summarised in paragraphs 18 and 19 above shows to have been required in relation to allegations of that gravity.

The application to file and serve the ASOC

74. I should start this section of this decision by saying that I agree with Mr Watkinson that "further and better particulars" is not the way that I would characterise the amendments to the SOC. The changes are considerable. Nevertheless I have concluded that, even if I had determined that the pleadings in the SOC were a sufficient basis for the Respondents' case, I would have acceded to the Respondents' application to amend the SOC in the form of the ASOC.

75. I say this because:

(1) once one takes into account the stay caused by the COVID 19 crisis, the delay between the filing and service of the SOC and filing and service of the ASOC was extremely brief;

(2) we are in any event at a very early stage in the proceedings;

(3) it is of considerable importance that the SOC should be amended in any event in order to set out the underlying facts as supplied by Mr Stewart Day of Younique in the course of 2019 in more detail, particularly as:

(a) those facts are inconsistent with the facts which were stated by the Appellant in its grounds of appeal;

(b) the First-tier Tribunal hearing the underlying appeal needs to approach its decision in the light of the actual facts; and

(c) that First-tier Tribunal may well find the very existence of the discrepancies between the facts as supplied by Mr Day and the facts as stated in the grounds of appeal to be of some relevance in reaching its conclusions in relation to the allegations of fraud; and

(4) as the Appellant's complaint about the SOC was that the SOC failed to set out the primary facts on which the Respondents intend to rely in establishing its case, the additional clarity afforded to the Respondents' position by the ASOC can only be welcomed by both the Appellant and the First-tier Tribunal which hears the underlying appeal.

76. It follows that, in my view, even if I had determined that the pleadings in the SOC were a sufficient basis for the Respondents' case to proceed, the balance of injustice test to which Pepperall J referred in *UBB Waste* would have suggested very strongly that the Respondents should be permitted to amend the SOC in the form of the ASOC. That conclusion is of course reinforced by the conclusions which I have set out above in relation to the terms of the SOC.

The ASOC

77. I should start by saying that, subject to the point in relation to *Kittel* actual knowledge which I will address in due course, I consider that the terms of the ASOC cure the difficulties in the SOC to which I have alluded in paragraphs 67 to 73 above.

78. This is because, in my view, the construction accorded to the ASOC by Mr Millington as set out in paragraph 47 above is the correct one. In particular, the ASOC is a single document and the headings which are set out at various junctures in the ASOC provide very clear guidance as to the meaning of the document. The structure of the section headed "RESPONDENTS' CASE", which starts at paragraph [47], is to set out various primary facts in relation first to Westbridge and then to the Appellant on which reliance is going to be placed in making the allegations of *Kittel* actual knowledge and *Fini* fraud and then to set out the allegations themselves in the section headed "The Denial". I do not agree with Mr Watkinson's reading of the document under which paragraphs [52] to [56] relate to the Respondents' *Kittel* actual knowledge case and then paragraphs [57] and [58] relate to the Respondents' *Fini* fraud case. To my mind, that interpretation involves an unnatural reading of the relevant paragraphs and giving insufficient attention to the clear signposts represented by the headings in the document.

79. When one adopts the approach to construction which I believe to be correct, it can be seen that, at least so far as the *Fini* fraud allegation is concerned, the relevant provisions of the ASOC are drafted in a way which cures the defects in the SOC to which I have alluded in paragraphs 67 to 73 above because, at paragraphs [47] to [55], the Respondents set out all the primary facts on which they intend to rely in order to succeed in their *Fini* fraud case against the Appellant and then, in paragraphs [57] and [58], the Respondents set out their allegation of fraud in reliance on *Fini*. In particular, in paragraphs [47] to [55], [57] and [58], the Respondents make it clear that the primary facts on which they intend to rely in pursuing their allegation of *Fini* fraud against the Appellant include:

(1) details of Westbridges prior and subsequent VAT defaults;

(2) details of the circumstances surrounding the present claims by the Appellant to deduct input tax, including the payments between the Appellant and Westbridge in respect of the supplies and the fact that Westbridge failed to account for the output tax;

(3) the fact that the alleged cash flow problems of Westbridge were unlikely to have been caused by any failure by the Appellant to pay any part of the consideration for the supplies to Westbridge;

(4) the fact that the work commitments which are alleged to have prevented Mr Stewart Day from filing VAT returns for Westbridge did not seem to have prevented Mr Day from filing the Appellant's VAT returns and;

(5) the common state of mind of the two companies as a result of their having the same sole director; and

(6) the fact that the Appellant knew that Westbridge would not pay the output tax relating to the supplies to which the input tax related and that that would give rise to a loss of tax for the Respondents and was dishonest conduct.

I conclude that there is more than enough information in those paragraphs for the Appellant to understand precisely the nature of the Respondents' case against it so far as the *Fini* fraud allegation is concerned.

80. There is however a significant defect in the ASOC so far as the pleading in relation to *Kittel* actual knowledge is concerned.

81. In its description of the primary facts in relation to the Appellant at paragraphs [52] to [55] of the ASOC, the Respondents have adopted a somewhat unusual approach in that paragraph [52] refers to the position at the time when the invoices were issued, whereas paragraph [53] refers to the position on the date when the Appellant submitted its VAT

repayment claim and paragraph [54] refers to the position at the time when the Appellant submitted its 05/19 return. I have no idea why the Respondents chose to draft these three paragraphs in the way that they have but, quite clearly, although the date in paragraph [53] and the time in paragraph [54] are the same, they are both different from the time in paragraph [52].

82. Moreover, in my view, although paragraphs [53] and [54] properly set out all of the primary facts on which the Respondents intend to rely to show that the Appellant had *Kittel* actual knowledge at the time when the Appellant submitted its repayment claim in its return for the 05/19 period, the date and time to which the facts in those paragraphs refer are later than the time at which the input tax in question became chargeable. Paragraph [52] does at least refer to a time which might be the time when the input tax became chargeable – as noted in paragraph 65 above, the time of supply rules are complicated and no argument in relation to how those rules would apply on the facts of this case were presented to me at the hearing - but the language used in that paragraph is too vague to amount to a proper pleading of the primary facts necessary to show that the Appellant had *Kittel* actual knowledge at the time when the invoices were issued. To say that "the Appellant acted in full knowledge of Westbridge's financial circumstances and VAT affairs, including its ongoing defaulting behaviour, its failure to account for or pay any output tax on the Denied Invoices, and its future intentions" is in my view too unspecific in nature to comprise a clear statement of the facts on which to found an allegation that the Appellant had Kittel actual knowledge of Westbridge's fraud. In order for this paragraph to have amounted to an adequate pleading of the primary facts on which the Respondents intended to rely to prove *Kittel* actual knowledge at the time when the invoices were issued, the Respondents would need to have recited the facts set out in the following two paragraphs but by reference to the earlier time.

83. The infelicities described in paragraph 82 above are then compounded by the drafting in paragraph [56], which is the plea in relation to *Kittel* actual knowledge, because that allegation contains no reference to a specific time at all. It merely refers to the fact that, "[in] the circumstances", the Appellant knew of Westbridge's fraud.

84. It can be seen from my analysis in paragraphs 55 to 65 above that, in my view, the correct time for assessing whether the recipient of a supply has the requisite actual knowledge of fraud by the supplier or by a person higher up the supply chain is the time when the input tax becomes chargeable and the satisfaction of the objective criteria which must be satisfied in order for that input tax to be recoverable falls to be tested. As that time necessarily precedes the time when the Appellant submitted its repayment claim in its return for the 05/19 period and, in any event, no time is specifically mentioned in the paragraph containing the *Kittel* actual knowledge allegation (paragraph [56]), I consider that the Respondents' pleading in the ASOC so far as it pertains to *Kittel* actual knowledge is defective and has no reasonable prospect of success as stated. That allegation must therefore be struck out.

85. In reaching that conclusion, I am mindful of the submission of Mr Millington that the precise time at which *Kittel* actual knowledge needs to be tested is sufficiently unclear and in the course of development by the courts that the issue is one which should be left to the First-tier Tribunal hearing the underlying appeal. I agree that an interlocutory hearing is not the place to deal with areas of the law which are unclear or are developing. However, notwithstanding the decisions in *Medallion* and *Victoria Walk*, it is in my view unarguable that the correct time for assessing the existence of *Kittel* actual knowledge is a point in time that falls after the time at which the input tax became chargeable. And, whenever that time might have been on the facts of this case, it was clearly before the time when the Appellant submitted its claim for the repayment of input tax in respect of the supplies in its 05/19 return. As:

(1) the ASOC does not set out, in relation to any point in time before the Appellant submitted its claim for the repayment of input tax, the primary facts which would need to be pleaded in order to support a plea based on *Kittel* actual knowledge; and

(2) there is, in any event, no reference to any specific time in the allegation of *Kittel* actual knowledge in paragraph [56] of the ASOC,

it is my view that, to use the language in the extract from *Fairford* set out in paragraph 10 above, the Respondents' *Kittel* pleading has no realistic prospect of success and is purely fanciful.

86. The same is true of the penalty under Section 69C of the VATA because that provision, by its terms, is clearly based on a successful *Kittel* claim, as Mr Watkinson pointed out in his submissions – see paragraph 42(1) above. In order for a person (T) to be liable to a penalty under that section in respect of a supply, three conditions need to be satisfied in relation to the transaction involving that supply. The first condition requires that the transaction be connected with the fraudulent evasion of VAT by another person "(whether occurring before or after T entered into the transaction)". The second requires that T "knew or should have known that the transaction was connected with the fraudulent evasion of VAT by another person". And the third requires that the Respondents have issued a decision in relation to the supply which prevents T from, inter alia, recovering the input tax in respect of the supply, is based on the facts which satisfy the first two conditions and applies the principles established by *Kittel* (or by another specified decision of the ECJ which is not relevant in the present case).

87. In my view, even if the Respondents were able to prove, at the hearing of the underlying appeal, that, based on the allegations in the ASOC, Westbridge has been guilty of fraud – so that the first condition is satisfied – they would not be able to meet the second and third conditions.

88. As regards the second condition, I have reflected on the fact that:

(1) the condition itself has no express reference to the time at which the relevant actual or constructive knowledge must exist; and

(2) the language used in the first condition expressly caters for the possibility that the fraud by the other person could arise either before or after the supply in question.

and I have considered whether that express language in the first condition should be taken as an indication that the second condition should be construed on the basis that it is capable of being satisfied by actual or constructive knowledge of the Appellant arising after the input tax in question became chargeable. However, I have concluded that that would not be the correct interpretation of the second condition. This is because the section as a whole is so clearly based on the denial of an input tax credit in reliance on the principle in *Kittel* that the most natural way to construe the second condition is by reference to the timing which is inherent in the *Kittel* principle. Moreover, as I have mentioned in paragraph 63(2) above, there is a distinction to be drawn between the date of the fraud the actual or constructive knowledge of which brings the *Kittel* principle into play and the time when that knowledge needs to exist. The mere fact that the fraud can arise after the time when the input tax becomes chargeable does not mean that the actual or constructive knowledge can also arise after that time. Indeed, the express reference in the first condition to the fact that the fraud can arise after the input tax becomes chargeable when no such reference exists in the second condition can be read as indicating that the restriction as to the time at which the knowledge must exist is implicit in the second condition.

89. Be that as it may, even if I am wrong in my interpretation of the second condition, it is quite clear that the third condition is not satisfied in this case, once the Respondents are no

longer able to rely on *Kittel* in seeking to deny the Appellant the ability to recover the input tax in question. This is because, as I have mentioned in paragraph 86 above, the third condition can be satisfied only if the Respondents are able to prevent the Appellant from recovering its input tax in reliance on *Kittel* and, for the reasons set out above, that is not the case.

90. For the above reasons, I have concluded that the part of the Respondents' case which relates to the penalty under Section 69C of the VATA must also be struck out.

ADDITIONAL PROVISIONS TO BE STRUCK OUT

91. In addition to striking out in the ASOC the Respondents' case to the extent that it relates to *Kittel* actual knowledge and the penalty, other changes should be made to the ASOC to reflect the terms of this decision. These are as follows:

(1) the word "purportedly" which appears in each of paragraph [14a] and paragraph [14b] should be deleted because it is clear that the Respondents accept that the invoices in question properly reflected actual commercial transactions and therefore reflected reality. The word "purportedly" is, in my view, unfairly pejorative given that acceptance;

(2) the paragraphs in the ASOC which refer to *Kittel* – paragraphs [34] to [42], paragraph [46b] and paragraph [56]– and to the penalty – paragraphs [45] and [64] - should be struck out as they pertain to pleas which have been struck out; and

(3) the reference to "abusive ends" in paragraph [46a] should be deleted as, by their own admission, the Respondents are not claiming that the Appellant is relying upon the right to deduct input tax for abusive ends.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

92. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Rules. 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.

TONY BEARE

TRIBUNAL JUDGE

RELEASE DATE: 16 OCTOBER 2020

APPENDIX 1

"INTRODUCTION

1. This appeal concerns decisions of the Commissioners of Her Majesty's Revenue and Customs ("HMRC" or "the Respondents") as follows:

    a. a decision notified by letter dated 24 July 2019 to refuse the Appellant's entitlement to the right to deduct input tax. The decision affects input tax totalling £78,000 claimed on: (i) the purchase of a finder's fee for the site Unit J, Swansea; and (ii) site management fees for the period January 2019 to May 2019. Both services were purchased from Westbridge Associates Limited ("Westbridge") in the 05/19 VAT period; and

    b. a decision dated 17 September 2019 to assess the Appellant for a penalty of £23,400 in relation to the input tax denied in the 05/19 period under section 69C of the Value Added Tax Act 1994. This penalty assessment was reduced to £21,060 following a review of the Appellant's case.

2. In outline, the Appellant purchased services (the finding of a site and site management) from Westbridge, the two companies being connected through a common director (Mr Stewart Day); however, while the Appellant claimed the right to deduct input tax with respect to those purchases, Westbridge failed to pay the associated output tax on the sales (or in fact any VAT at all) and against which a notice for strike off was made in December 2019. The decision to deny the right to claim input tax was taken on the basis either that the right to deduct was being relied on for fraudulent or abusive ends, or, alternatively, that the transactions concerned were connected with the fraudulent evasion of VAT and that the Appellant knew or ought to have known of that fact.

3. By letter dated 27 November 2019, the Respondents notified the Appellant that the decision was upheld on review.

4. By Notice of Appeal dated 23 December 2019 the Appellant appealed the decisions.

GROUNDS OF APPEAL

5. The Appellant sets out its grounds of appeal as follows:

'The technical basis of HMRC's denial is that input tax should be denied where a taxable person "knew or should have known that its transactions were connected with VAT fraud."

We believe that the reasons HMRC's denial of input tax recovery is that there was a deliberate plan that Westbridge Associates Limited (WAL) would not declare and pay its output VAT to HMRC. If this was the case then we accept there would have been a loss of tax to HMRC.

In order for HMRC's denial of input tax recovery to be validly made AMW would need to have involvement in or knowledge of a fraud. The burden of proof is on HMRC to show that AMW "knew of should have known" that it was participating in a transaction connected with VAT fraud (Mobilx Limited v HMRC).

We do not believe that HMRC has proved this to be the case.

Moses LJ in the Mobil [sic] case stated that "a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion".

In the case of AMW we confirm that it had received genuine commercial invoices from WAL which were 'Finder's Fees' for sourcing land. These fees were charged at 10% of the purchase price of the relevant plots of and. Investopedia states that land sourcing charges vary between 5% and 35% of the cost of the land and our client therefore believes that 10% is a reasonable commercial fee for this service.

We understand that WAL has provided land finding services to other companies and has charged other customers fees for their work. It is a normal trading business which charges for its services.

The test that the only reasonable explanation could be that the transaction was connected with fraudulent evasion is therefore failed. The explanation in fact was that the fee charged was a commercial fee for services provided. Land was identified by WAL and a fee was charged for this service.

In summary the facts in this case are:

1. WAL provided a normal commercial service (for which it had other customers, not only AMW). It charged AMW at its normal rate for these services which is a supportable commercial rate;

2. AMW had received the services;

3. AMW's intention was (and remains) to make taxable supplies in the course of its business.

We also confirm that there was no fraud or deliberate attempt to avoid payment of the output VAT. Indeed WAL has filed its VAT Returns which declare the relevant output VAT as being payable to HMRC.

We accept that there has been a delay in WAL filing its VAT Returns. This was mainly because WAL is concerned about how it will be able to fund payment to HMRC of the output VAT. WAL has been paid the 'net' fees charged to AMW but the VAT element has not yet been settled by its customer. This is because AMW planned to settle the VAT element of the invoice out of the cash flow generated by the reclaim of its input tax. This would then be paid by WAL to HMRC.

WAL is therefore extremely concerned about how it will be able to fund payment of the output VAT liability. If HMRC denies the input tax recovery in AMW, AMW will be unable to pay the VAT element of the invoice and WAL will have to find additional cash resources to pay its out VAT.

In summary we believe that input tax should be recoverable in full."

6. The Appellant then sets out various issues and other business circumstances that it appears to feel should be taken into account (cash flow issues for the Appellant and Westbridge and personal issues putting strain on Mr Day).

BACKGROUND OF APPELLANT AND WESTBRIDGE ASSOCIATES LIMITED

7. With respect to the Appellant:

a. The company was incorporated on 25 March 2014 with company number 08957105 and registered for VAT as from 1 August 2015, with VAT Registration Number 223 8483 05.

b. Its registered office is at 3rd Floor, Middleborough House, 16 Middleborough, Colchester CO1 1QT. Prior to this the registered office was at Unit 18, Cunningham Court, Blackburn BB1 2QX (20 December 2018 to 28 March 2019); 72 Rhosmaen Street, Llandello, Dyfed SA19 6EN (25 April 2016 to 20 December 2018) and Morgans Hotel, Somerset Place, Swansea SA1 1RR (25 March 2014 to 25 April 2016).

c. The company has one director: Mr Stewart Day, appointed on 17 December 2018. The company has had a number of other directors, they are set out below:

    i. Stephen William Harrison (appointed 25 March 2014, resigned 17 December 2018);

    ii. Lee Morridge (appointed 23 May 2014, resigned 17 December 2018);

    iii. Charles Elliot Morgan (appointed 31 March 2015, resigned 17 December 2018); and

    iv. Douglas Benjamin Villiers (appointed 17 December 2018, resigned 17 December 2018).

d. The sole shareholder of the Appellant is a company called TMG Swansea Limited (company number 11541497). Mr Stewart Day is the director and sole shareholder of TMG Swansea.

e. The nature of the company's business, as listed in its Companies House record, is 'Buying and selling of own real estate.'

8. The company has failed to submit regular VAT returns. During the denial period, and the year leading up to it, the company failed to submit returns for the 05/18, 08/18, 11/18 and 02/19 periods but they did submit a return for the 05/19 period which covered a period of 28 months. They declared inputs of £469,830 and no outputs and requested a repayment of £93,957 of input tax. No reason has been given for the delay in providing returns.

9. With respect to Westbridge:

a. The company was incorporated on 27 June 2017 with company number 10836565 and registered for VAT as from 27 June 2017 with VAT Registration Number 275 2649 77.

b. Its registered office is and has always been at Unit 18, Cunningham Court, Blackburn BB1 2QX.

c. The company has one director: Mr Stewart Day, appointed on 27 June 2017. Mr Glenn Thomas was also appointed as director on 27 June 2017 but resigned on the same date.

d. The company has two shareholders (Mr Stewart Day with 50 of 90 shares and Mr Thomas with 40 of 90 shares. Mr Stewart Day is therefore the majority shareholder of Westbridge.

e. The nature of the company's business, as listed in its Companies House record, is 'Buying and selling of own real estate.'

f. Prior to 9 November 2019 the company had failed to submit any VAT returns. On 9 November 2019 (after the decision to deny the Appellant's input tax) the outstanding returns were submitted. No reasons were provided for the delay. These returns are summarised as follows:

VAT period	Outputs	Inputs	Total output tax	Input tax	Net tax
09/17	£700,000	£577,534	£140,000	£115,507	£24,493
12/17	£14,167	£13,519	£2,833	£2,694	£139
03/18	£152,167	£2,342	£30,433	£467	£29,966
06/18	£0	£0	£0	£0	£0
09/19	£1,320,000	£4,167	£264,000	£833	£263,167

g. Despite having submitted the returns Westbridge has not paid any of the VAT owed to the Respondents (totalling £318,364.06). There has been no explanation provided by the company other than general cash flow issues as to why the amount owed has not been paid.

h. Various applications for strike off have been made in relation to Westbridge, the first on 18 September 2018 which was discontinued on 9 October 2018 after cause was shown as to why it should not be struck off. A second compulsory strike off notice was issued on 28 May 2019 but was again discontinued on 3 August 2019. On 17 December 2019 a third notice for compulsory strike off was made. Strike off action has been suspended pending an objection to the strike off.

10. The Respondents understand that the current director of each company named as Mr Stewart Day to be the same individual. Mr Day was an active director of both companies during the time in which the denied transactions were undertaken. Mr Day is also directly or indirectly the sole or majority shareholder of both companies.

11. The nature of the relationship between the Appellant and Westbridge was, so far as the Respondents understand, the supply of services by Westbridge to the Appellant. Evidence submitted in support of the Appellant's VAT returns indicates that such services were described as a finder's fees and site management fees which is not wholly consistent with the nature of Westbridge's business on Companies House where no mention of site management is made.

12. The Respondents have been unable to establish whether Westbridge had customers other than the Appellant as the Appellant contends.

PROCEDURAL BACKGROUND

13. The Appellant's VAT return for the 05/19 period, which indicated a repayment owed to the Appellant, was selected by the Respondents for verification. In order to undertake said verification the HMRC Officer responsible, Officer Jeffares, arranged for a visit to be undertaken to the Appellant. A visit was therefore arranged for 11 June 2019 at the Appellant's accountant's office (Younique Accountancy Limited, Cobalt Business Exchange, Cobalt Park Way, Newcastle upon Tyne NE28 9NZ) ("Younique")). Kelly Boot (a senior accountant) and Neil Day (the director of Younique) were present but Mr Stewart Day (the director of the Appellant) was not. The nature of the business was discussed and it was confirmed that Younique completed the VAT returns. It was established that the Appellant was acquired in December 2018 by TMG Swansea Limited (owned by Mr Stewart Day) with all previous directors resigning and Mr Stewart Day being appointed as sole director at the time of purchase. At this meeting

the two invoices from Westbridge that are the subject of the input tax denial were provided to Officer Jeffares.

14. Officer Jeffares considered the invoices from Westbridge and having checked departmental systems noted that it had been deemed to be a missing trader having not submitted any VAT returns since it was registered for VAT. HMRC had raised central assessments for a total of £40,430 none of which had been paid.

15. By letter dated 24 July 2019, the Respondents notified the Appellant that a decision had been taken to refuse the company's entitlement to the right to deduct input tax, totalling £78,000, in connection with transactions during the 05/19 period (**Appendix 1**).

16. The letter referred to the European Court of Justice's judgments in the case of I*/S Fini H* (C-32/03) and in the joined cases of *Axel Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL* (C-439/04 and C440/04), and stated that:

> *'The Commissioners are satisfied that you have exercised the right to deduct upon the transactions set out below for fraudulent or abusive ends. Alternatively the Commissioners are satisfied that those transactions were connected with the fraudulent evasion of VAT and that you know or should have known that this was the case.*
>
> *Accordingly your claim to input tax in respect of these transactions is denied.'*

17. The reasons given by the Respondents were set out in the letter and are expanded upon in the Respondents' submissions at paragraphs 40 to 45 below.

18. On 16 August 2019 the Appellant's accountants wrote to Officer Jeffares requesting further clarification as to the reasons for the decision and explaining that the Appellant was aware that Westbridge was behind in providing its VAT returns and would make sure that these were brought up to date within 28 days. A response was provided by Officer Jeffares on 23 August 2019. He also indicated that he would be allowing the remainder of the repayment from the 05/19 return (excluding the £78,000 that had been denied).

19. On 17 September 2019 pursuant to section 69C of the Value Added Tax Act 1994 the Appellant was assessed for a penalty based on the transactions denied in the decision of 24 July 2019 (**Appendix 2**).

20. By way of a letter dated 14 October 2019 the Appellant requested a review of the decision of 24 July 2019 and 17 September 2019.

21. The Respondents undertook the requested review but by a decision dated 27 November 2019 they upheld the decision to deny the Appellant's input tax in the sum of £78,000 and the decision to assess the Appellant for a penalty in the sum of £23,400 although it was accepted that a 10% mitigation should be applied given the assistance provided by the Appellant and the penalty was reduced to £21,060 (**Appendix 3**).

LEGAL FRAMEWORK

The right to deduct input tax

22. Under Community law, the right to deduct input tax from the VAT that a taxable person is liable to pay is contained in Articles 167 and 168 of Council Directive 2006/112/EC of 278 November 2006 on the common system of VAT, which provide:

> *"**Article 167***
> *The right of deduction shall arise at the time the deductible tax becomes charged.*
> *...*
> ***Article 168***
> *In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:*
>
> *(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person.*
>
> *..."*

23. Sections 24, 25 and 26 of the VAT Act 1994 provide:

> *"**24 Input tax and output tax***
> *(1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—*
>
> *(a) VAT on the supply to him of any goods or services;*
> *(b) VAT on the acquisition by him from another member State of any goods; and*

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

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

...

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

(1) A taxable person shall—

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

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

account for and pay VAT by reference to such periods (in this Act referred to as "prescribed accounting periods") at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

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

...

26 Input tax allowable under section 25

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

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

(a) taxable supplies;

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

(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of the subsection.

..."

24. Regulation 29 of the VAT Regulations 1995, as amended by the VAT (Amendment) Regulations, SI 2009/586, provides:

> *"**29 Claims for input tax***
>
> *(1) Subject to paragraph (1A) below, and save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable save that, where he does not at that time hold the document or invoice required by paragraph (2) below, he shall make his claim on the return for the first prescribed accounting period in which he holds that document or invoice.*
>
> *…"*

25. The effect of these provisions is that a taxable person may set allowable input tax against his output tax liability, thereby either reducing the amount of VAT that is due or, if the input tax credit exceeds the output tax liability, giving rise to a repayment.

Denial of the right to deduct input tax

26. The European Court of Justice ("ECJ") has held that the right to deduct input tax may be denied where it is relied on for fraudulent or abusive ends. In its judgment in *I/S Fini H* (C-32/03 – "*Fini*"), the ECJ stated at [32]–[34]:

> *"32. …the Court has already held that Community law cannot be relied on for abusive or fraudulent ends…*
>
> *33. If the tax authorities were to conclude that the right to deduct has been exercised fraudulently or abusively, they would be entitled to demand, with retrospective effect, repayment of the amounts deducted…*
>
> *34. It is, in any event, a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that this right is being relied on for fraudulent or abusive ends."*

27. The ECJ has also held that the right to deduct input tax may be denied where a taxable person knew or should have known that the transactions to which the claim for input tax relates were connected with the fraudulent evasion of VAT. In the joined cases *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04 – "*Kittel*"), the ECJ stated at [56]–[59]:

"56. … a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'."

28. The principles set out in *Kittel* and *Fini* have been further considered in a series of domestic decisions. In *Mobilx Ltd (in Administration) v HMRC* [2010] EWCA Civ 517 ("*Mobilx*"), Moses LJ stated at [52]:

52. "If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in Kittel. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

29. Specifically, looking at the two principles, Moses LJ stated at [35]-[36] and [41]:

35."From § 53-55 in Kittel the Court set out the starting point for its development of the principles relating to cases where the taxable person was himself acting fraudulently:-

"53. By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic

activity' are not met where tax is evaded by the taxable person himself (see Case C-255/02 Halifax and Others [2006] ECR I-0000, paragraph 59).

54. As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 Gemeente Leusden and Holin Groep [2004] ECR I-5337, paragraph 76). Community law cannot be relied on for abusive or fraudulent ends (see, inter alia, Case C-367/96 Kefalas and Others [1998] ECR I-2843, paragraph 20; Case C-373/97 Diamantis [2000] ECR I-1705, paragraph 33; and Case C-32/03 Fini H [2005] ECR I-1599, paragraph 32).

55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 Rompelman [1985] ECR 655, paragraph 24; Case C-110/94 INZO [1996] ECR I-857, paragraph 24; and Gabalfrisa, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see Fini H, paragraph 34)."

36.The Court's reference, in § 55, to a quartet of previous decisions reinforces the proposition that fraudulent tax evasion falls outwith the scope of VAT and thus the scope of the right to deduct input tax. Fraudulent evasion of tax does not meet the objective criteria, such as whether the activity is "economic activity" or a taxable person is "acting as such", by which the scope of VAT and of the right to deduct are identified.

41. In Kittel after § 55 the Court developed its established principles in relation to fraudulent evasion. It extended the principle, that the objective criteria are not met where tax is evaded, beyond evasion by the taxable person himself to the position of those who knew or should have known that by their purchase they were taking part in a transaction connected with fraudulent evasion of VAT:-

"56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a

participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them."

59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'. [emphasis added]"

The words I have emphasised "in the same way" and "therefore" link those paragraphs to the earlier paragraphs between 53-55. They demonstrate the basis for the development of the Court's approach. It extended the category of participants who fall outwith the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. Kittel did represent a development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct.

30. Considering the requirement that a taxable person knew or should have known that transactions were connected with the fraudulent evasion of VAT, Moses LJ stated at [59]–[60]:

> *"59. The test in Kittel is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation*

for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in Kittel.

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

31. Considering questions of proof, Moses LJ stated at [81] "that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion." He went on at [82] to state:

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

32. At [83], Moses LJ affirmed guidance on the treatment of circumstantial evidence in such cases that had been set out by Christopher Clarke J in *Red 12 v HMRC* [2009] EWHC 2563, as follows:

> *"109 Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of*

transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

110 To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.

111 Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

33. In *Fonecomp Ltd v HMRC [2015] EWCA Civ 39*, Arden LJ confirmed at [45] that "there is nothing in Kittel which would lead to the conclusion that HMRC has to show that the transaction provides tangible assistance in carrying out the fraud." She went on at [48] to state that:

> *"Lack of knowledge of the specific mechanics of a VAT fraud affords no basis for any argument that the decision of either tribunal was wrong in law: what is required is simply participation with knowledge in a transaction 'connected with fraudulent evasion of VAT'…*"

34. Considering *Mobilx* in particular, she went on at [51] to state that:

> *"However, in my judgment, the holding of Moses LJ does not mean that the trader has to have the means of knowing how the fraud that actually took place occurred. He has simply to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some transaction to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge. This is apparent from [56] and [61] of* Kittel *cited above. Paragraph 61 of* Kittel *formulates the requirement of knowledge as knowledge on the part of the trader that 'by his purchase he was participating in a transaction connected with fraudulent evasion of VAT'. It follows that the trader does not need to know the specific details of the fraud."*

35. In *AC (Wholesale) Ltd v HMRC [2017] UKUT 191 (TCC),* the Upper Tribunal considered *Mobilx* and stated that "…the 'only reasonable explanation' test is simply one way of showing that a person should have known that transactions were connected to fraud." The Upper Tribunal went on to state that:

> *"29. It is, to us, inconceivable that Moses LJ's example of an application of part of that test, the 'no other reasonable explanation', would lead to the test becoming more complicated and more difficult to apply in practice. That, in our view, would be the consequence of applying the interpretation urged upon us by Mr. Brown. In effect, HMRC would be required to devote time and resources to considering what possible reasonable explanations, other than a connection with fraud, might be put forward by an appellant and then adduce evidence and argument to counter them even where the appellant has not sought to rely on such explanations. That would be an unreasonable and unjustified evidential burden on HMRC. Accordingly, we do not consider that HMRC are required to eliminate all possible reasonable explanations other than fraud before the FTT is entitled to conclude that the appellant should have known that the transactions were connected to fraud.*
>
> *30. Of course, we accept (as, we understand, does HMRC) that where the appellant asserts that there is an explanation (or several explanations) for the circumstances of a transaction other than a connection with fraud then*

it may be necessary for HMRC to show that the only reasonable explanation was fraud. As is clear from Davis & Dann, the FTT's task in such a case is to have regard to all the circumstances, both individually and cumulatively, and then decide whether HMRC have proved that the appellant should have known of the connection with fraud. In assessing the overall picture, the FTT may consider whether the only reasonable conclusion was that the purchases were connected with fraud. Whether the circumstances of the transactions can reasonably be regarded as having an explanation other than a connection with fraud or the existence of such a connection is the only reasonable explanation is a question of fact and evaluation that must be decided on the evidence in the particular case. It does not make the elimination of all possible explanations the test which remains, simply, did the person claiming the right to deduct input tax know that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT or should he have known of such a connection."

Burden and standard of proof

36. The Respondents acknowledge that they bear the burden of proving that the transactions in question were without the scope of the right to deduct input tax. In *Mobilx & Others*, Moses LJ stated at [82]:

> *'It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion....But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant...'*

37. The standard of proof is the civil standard of the balance of probabilities, there no longer being a 'heightened civil standard'. In *Re B* [2009] 1 AC 11, Lord Hoffman stated at [13] that, '*I think that the time has come to say, once and for all, that there is only one civil standard of proof, and that is proof that the fact in issue more probably occurred than not*'.

Penalties

38. Section 69C of the VAT Act 1994 states as follows:

> ***69C Transactions connected with VAT fraud***
>
> *(1) A person (T) is liable to a penalty where—*

(a) T has entered into a transaction involving the making of a supply by or to T ("the transaction"), and

(b) conditions A to C are satisfied.

(2) Condition A is that the transaction was connected with the fraudulent evasion of VAT by another person (whether occurring before or after T entered into the transaction).

(3)Condition B is that T knew or should have known that the transaction was connected with the fraudulent evasion of VAT by another person.

(4)Condition C is that HMRC have issued a decision ("the denial decision") in relation to the supply which—

(a) prevents T from exercising or relying on a VAT right in relation to the supply,

(b) is based on the facts which satisfy conditions A and B in relation to the transaction, and

(c) applies a relevant principle of EU case law (whether or not in circumstances that are the same as the circumstances in which any relevant case was decided by the European Court of Justice).

(5) In this section "VAT right" includes the right to deduct input tax, the right to apply a zero rate to international supplies and any other right connected with VAT in relation to a supply.

(6) The relevant principles of EU case law for the purposes of this section are the principles established by the European Court of Justice in the following cases—

(a) joined Cases C-439/04 and C-440/04 Axel Kittel v. Belgian State; Belgium v. Recolta Recycling (denial of right to deduct input tax), and

(b) Case C-273/11 (b) Mecsek-Gabona Kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága (denial of right to zero rate), as developed or extended by that Court (whether before or after the coming into force of this section) in other cases relating to the denial or refusal of a VAT right in order to prevent abuses of the VAT system.

(7) The penalty payable under this section is 30% of the potential lost VAT.

(8) The potential lost VAT is—

(a) the additional VAT which becomes payable by T as a result of the denial decision,

(b) the VAT which is not repaid to T as a result of that decision, or

(c) in a case where as a result of that decision VAT is not repaid to T and additional VAT becomes payable by T, the aggregate of the VAT that is not repaid and the additional VAT.

(9) Where T is liable to a penalty under this section the Commissioners may assess the amount of the penalty and notify it to T accordingly.

(10) No assessment of a penalty under this section may be made more than two years after the denial decision is issued.

(11) The assessment of a penalty under this section may be made immediately after the denial decision is made (and notice of the assessment may be given to T in the same document as the notice of the decision).

(12) Where by reason of actions involved in making a claim to exercise or rely on a VAT right in relation to a supply T—

(a) is liable to a penalty for an inaccuracy under paragraph 1 of Schedule 24 to the Finance Act 2007 for which T has been assessed (and the assessment has not been successfully appealed against by T or withdrawn), or

(b) is convicted of an offence (whether under this Act or otherwise), those actions do not give rise to liability to a penalty under this section.]

ISSUES

39. The issues to be determined are as follows:

    a. whether the right to deduct input tax had been relied upon for fraudulent or abusive ends; or, alternatively,

    b. whether the transactions with respect to which the right to deduct input tax was denied were connected with the fraudulent evasion of VAT, and that the Appellant knew, or should have known, that that was the case. Specifically:

i. whether there was a tax loss;

ii. whether that tax loss due to fraudulent evasion;

iii. whether the transactions in question were connected to the tax loss; and

iv. whether the Appellant knew, or should have known, that that was the case.

RESPONDENTS' CASE

Denial of Input Tax

40. The Respondents' case is that, with respect to purchases made from Westbridge, the Appellant relied upon the right to deduct input tax for fraudulent or abusive ends.

41. In support of this contention, the Respondents rely, in particular, on the following:

a. Through their common director and shareholder, it can be inferred that the Appellant and Westbridge must have acted in full knowledge of the other, including the other's intentions, its financial circumstances and, for example, sums paid or owing to the Respondents.

b. The Appellant's reliance in its notice of appeal on a claimed cash-flow problem depends on it having been an innocent coincidence that the cash-flow problem would give rise to an underpayment by the Appellant to Westbridge almost exactly equal to the output tax on the transactions, thereby allowing Westbridge to cover all of its outgoings except for the VAT owed to the Respondents. In all the circumstances of the case, the Respondents submit that this is not credible.

c. The existence of a cash-flow problem would not, in itself, explain why none of the funds passed from the Appellant to Westbridge, over several months, were used to pay any of the VAT owed by Westbridge to the Respondents.

d. The Appellant's reliance on a cash-flow problem also implies that it was an innocent coincidence that the alleged cash-flow problem coincided with the creation of the Appellant and the decision for it to trade with Westbridge (also owned by the same director). In all the circumstances of the case, the Respondents submit that this is not credible.

e. Before its notice of appeal, the Appellant had not, so far as the Respondents are aware, previously made reference to any cash-flow problem, including during its

communications with Officer Jeffares. Even at this stage, the Appellant has provided few details.

f. Similarly, so far as the Respondents are aware, Westbridge did not contact the Respondents to inform them that the company would be unable to make its VAT payments or to request additional time to pay.

g. In light of the above, the Respondents submit that a cash-flow problem cannot, in itself, plausibly account for the facts underlying the decision to deny the Appellant's claim for input tax.

h. Irrespective of any cash-flow problem, the Respondents submit that it can be reasonably inferred from all the circumstances of the case that the Appellant intentionally underpaid Westbridge by an amount approximately equal to the output tax that would be due on the transactions, in the knowledge that Westbridge would not then pay the output tax due on the transactions to the Respondents.

i. Further the fact that the fees charged by Westbridge to the Appellant were standard commercial fees does not affect the conclusion that the transactions in question were undertaken for fraudulent or abusive ends.

j. In such circumstances, the Respondents submit that to claim the right to deduct input tax for the transactions in question is to do so for fraudulent or abusive ends.

42. Alternatively, the Respondents submit that the transactions for which the Appellant's right to deduct input tax was denied were connected with the fraudulent evasion of VAT, and that the Appellant knew, or should have known, as much.

43. In support of this contention, the Respondents rely on the same facts and inferences as set out at paragraph 41 above. In particular:

a. Westbridge's failure to submit VAT returns and pay the VAT due to the Respondents. The fact that it has now, after the event, submitted those returns is irrelevant especially as no payment has been made.

b. The Respondents submit that the tax loss caused by Westbridge's default was due to fraudulent evasion and relies, in support, on the features set out at paragraph 41 above.

c. Westbridge's tax loss arose from a failure to pay output tax on the transactions for which the Appellant's right to deduct input tax was refused. Those transactions are therefore connected with the tax loss.

d. Through the common directors of the two companies, the Appellant must have known, or ought to have known, that the transactions in question were connected to the fraudulent tax losses attributable to Westbridge.

44. The Respondents therefore submit that input tax was correctly denied on one or both of the bases set out above.

Penalty

45. The Appellant further contests the penalty assessment that it has been issued. It is submitted that the penalty was made under section 69C of the VAT Act 1994. This provides for the assessment of a penalty for transactions connected with VAT fraud where it can be established that the business knew or should have known that its transactions were connected with VAT fraud. In such circumstances a penalty will be charged at 30% of the VAT amount denied. For the reasons set out above the Respondents submit that the Appellant knew or should have known that the transactions were connected with VAT fraud and that as such the penalty was correctly assessed.

CONCLUSION

46. For the reasons given, it is respectfully submitted that the appeal ought to be dismissed."

APPENDIX 2

"INTRODUCTION

1. This appeal concerns decisions of the Commissioners of Her Majesty's Revenue and Customs ("HMRC" or "the Respondents") as follows:

   a. a decision notified by letter dated 24 July 2019 to refuse the Appellant's entitlement to the right to deduct input tax. The decision affects input tax totalling £78,000 claimed on: (i) the purchase of a finder's fee for the site Unit J, Swansea; and (ii) site management fees for the period January 2019 to May 2019. Both services were purchased from Westbridge Associates Limited ("Westbridge") in the 05/19 VAT period; and

   b. a decision dated 17 September 2019 to assess the Appellant for a penalty of £23,400 in relation to the input tax denied in the 05/19 period under section 69C of the Value Added Tax Act 1994. This penalty assessment was reduced to £21,060 following a review of the Appellant's case.

2. In outline, the Appellant purchased services (the finding of a site and site management) from Westbridge, the two companies being connected through a common director (Mr Stewart Day); however, while the Appellant claimed the right to deduct input tax with respect to those purchases, Westbridge failed to pay the associated output tax on the sales (or in fact any VAT at all) and against which a notice for strike off was made in December 2019. The decision to deny the right to claim input tax was taken on the basis either that the right to deduct was being relied on for fraudulent or abusive ends, or, alternatively, that the transactions concerned were connected with the fraudulent evasion of VAT and that the Appellant knew or ought to have known of that fact.

3. By letter dated 27 November 2019, the Respondents notified the Appellant that the decision was upheld on review.

4. By Notice of Appeal dated 23 December 2019 the Appellant appealed the decisions.

GROUNDS OF APPEAL

5. The Appellant sets out its grounds of appeal as follows:

   'The technical basis of HMRC's denial is that input tax should be denied where a taxable person "knew or should have known that its transactions were connected with VAT fraud."

We believe that the reasons HMRC's denial of input tax recovery is that there was a deliberate plan that Westbridge Associates Limited (WAL) would not declare and pay its output VAT to HMRC. If this was the case then we accept there would have been a loss of tax to HMRC.

In order for HMRC's denial of input tax recovery to be validly made AMW would need to have involvement in or knowledge of a fraud. The burden of proof is on HMRC to show that AMW "knew of should have known" that it was participating in a transaction connected with VAT fraud (Mobilx Limited v HMRC).

We do not believe that HMRC has proved this to be the case.

Moses LJ in the Mobil [sic] case stated that "a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion".

In the case of AMW we confirm that it had received genuine commercial invoices from WAL which were 'Finder's Fees' for sourcing land. These fees were charged at 10% of the purchase price of the relevant plots of and. Investopedia states that land sourcing charges vary between 5% and 35% of the cost of the land and our client therefore believes that 10% is a reasonable commercial fee for this service.

We understand that WAL has provided land finding services to other companies and has charged other customers fees for their work. It is a normal trading business which charges for its services.

The test that the only reasonable explanation could be that the transaction was connected with fraudulent evasion is therefore failed. The explanation in fact was that the fee charged was a commercial fee for services provided. Land was identified by WAL and a fee was charged for this service.

In summary the facts in this case are:

1. *WAL provided a normal commercial service (for which it had other customers, not only AMW). It charged AMW at its normal rate for these services which is a supportable commercial rate;*

2. *AMW had received the services;*

3. AMW's intention was (and remains) to make taxable supplies in the course of its business.

We also confirm that there was no fraud or deliberate attempt to avoid payment of the output VAT. Indeed WAL has filed its VAT Returns which declare the relevant output VAT as being payable to HMRC.

We accept that there has been a delay in WAL filing its VAT Returns. This was mainly because WAL is concerned about how it will be able to fund payment to HMRC of the output VAT. WAL has been paid the 'net' fees charged to AMW but the VAT element has not yet been settled by its customer. This is because AMW planned to settle the VAT element of the invoice out of the cash flow generated by the reclaim of its input tax. This would then be paid by WAL to HMRC.

WAL is therefore extremely concerned about how it will be able to fund payment of the output VAT liability. If HMRC denies the input tax recovery in AMW, AMW will be unable to pay the VAT element of the invoice and WAL will have to find additional cash resources to pay its out VAT.

In summary we believe that input tax should be recoverable in full."

6. The Appellant then sets out various issues and other business circumstances that it appears to feel should be taken into account (cash flow issues for the Appellant and Westbridge and personal issues putting strain on Mr Stewart Day). In particular, the Appellant relies on the collapse of Lendy, a peer to peer lender, which suspended all borrower's loans by December 2018 and entered administration in June 2019. It is claimed that this placed huge pressures on Stewart Day and his business interests.

BACKGROUND OF APPELLANT AND WESTBRIDGE ASSOCIATES LIMITED

7. With respect to the Appellant:

   a. The company was incorporated on 25 March 2014 with company number 08957105 and registered for VAT as from 1 August 2015, with VAT Registration Number 223 8483 05.

   b. Its registered office is at 3rd Floor, Middleborough House, 16 Middleborough, Colchester CO1 1QT. Prior to this the registered office was at Unit 18,

Cunningham Court, Blackburn BB1 2QX (20 December 2018 to 28 March 2019); 72 Rhosmaen Street, Llandello, Dyfed SA19 6EN (25 April 2016 to 20 December 2018) and Morgans Hotel, Somerset Place, Swansea SA1 1RR (25 March 2014 to 25 April 2016).

c. The company has one director: Mr Stewart Day, appointed on 17 December 2018. The company has had a number of other directors, they are set out below:

i. Stephen William Harrison (appointed 25 March 2014, resigned 17 December 2018);

ii. Lee Morridge (appointed 23 May 2014, resigned 17 December 2018);

iii. Charles Elliot Morgan (appointed 31 March 2015, resigned 17 December 2018); and

iv. Douglas Benjamin Villiers (appointed 17 December 2018, resigned 17 December 2018).

d. The sole shareholder of the Appellant is a company called TMG Swansea Limited (company number 11541497). Mr Stewart Day is the director and sole shareholder of TMG Swansea Limited. TMG Swansea Limited was incorporated on 29 August 2018. Its registered address is Unit 18 Cunningham Court, Lions Drive, Blackburn, England, BB1 2QX.

e. The nature of the company's business, as listed in its Companies House record, is 'Buying and selling of own real estate.'

8. The ~~company~~ Appellant has failed to submit regular VAT returns. During the denial period, and the year leading up to it, the company failed to submit returns for the 05/18, 08/18, 11/18 and 02/19 periods but they did submit a return for the 05/19 period which covered a period of 28 months. They declared inputs of £469,830 and no outputs and requested a repayment of £93,957 of input tax. No reason has been given for the delay in providing returns.

9. With respect to Westbridge:

a. The company was incorporated on 27 June 2017 with company number 10836565 and registered for VAT as from 27 June 2017 with VAT Registration Number 275 2649 77.

b. ~~Its registered office is and has always been at~~ From the date of its incorporation until 20 May 2020 its registered office was Unit 18, Cunningham Court, Blackburn BB1 2QX. On 20 May 2020, this was changed to Cobalt 3.1 Silver Fox Way, Cobalt Business Park, Newcastle Upon Tyne, England, NE27 0QJ.

c. The company has one director: Mr Stewart Day, appointed on 27 June 2017. Mr Glenn Thomas was also appointed as director on 27 June 2017 but resigned on the same date.

d. The company has two shareholders: ~~(~~Mr Stewart Day with 50 of 90 shares and Mr Thomas with 40 of 90 shares. Mr Stewart Day is therefore the majority shareholder of Westbridge.

e. The nature of the company's business, as listed in its Companies House record, is 'Buying and selling of own real estate.'

f. Prior to 9 November 2019 the company had failed to submit any VAT returns. On 9 November 2019 (after the decision to deny the Appellant's input tax) the outstanding returns were submitted. No reasons were provided for the delay. These returns are summarised as follows:

VAT period	Outputs	Inputs	Total output tax	Input tax	Net tax
09/17	£700,000	£577,534	£140,000	£115,507	£24,493
12/17	£14,167	£13,519	£2,833	£2,694	£139
03/18	£152,167	£2,342	£30,433	£467	£29,966
06/18	£0	£0	£0	£0	£0
09/19	£1,320,000	£4,167	£264,000	£833	£263,167

g. Despite having submitted the returns Westbridge has not paid any of the VAT owed to the Respondents (totalling £318,364.06). There has been no explanation provided by the company other than general cash flow issues as to why the amount owed has not been paid.

h. Various applications for strike off have been made in relation to Westbridge, the first on 18 September 2018 which was discontinued on 9 October 2018 after

cause was shown as to why it should not be struck off. A second compulsory strike off notice was issued on 28 May 2019 but was again discontinued on 3 August 2019. On 17 December 2019 a third notice for compulsory strike off was made. ~~Strike off action has been suspended pending an objection to the strike off.~~ On 13 May 2020 compulsory strike-off action was discontinued.

10. The Respondents understand that the current director of each company named as Mr Stewart Day to be the same individual. Mr Day was an active director of both companies during the time in which the denied transactions were undertaken. Mr Day is also directly or indirectly the sole or majority shareholder of both companies.

11. The nature of the relationship between the Appellant and Westbridge was, so far as the Respondents understand, the supply of services by Westbridge to the Appellant. Evidence submitted in support of the Appellant's VAT returns indicates that such services were described as a finder's fees and site management fees which is not wholly consistent with the nature of Westbridge's business on Companies House where no mention of site management is made.

12. The Respondents have been unable to establish whether Westbridge had customers other than the Appellant as the Appellant contends.

~~PROCEDURAL BACKGROUND~~ THE DECISION

13. The Appellant's VAT return for the 05/19 period, which indicated a repayment owed to the Appellant, was selected by the Respondents for verification. In order to undertake said verification ~~the HMRC Officer responsible, Officer Jeffares, arranged for a visit to be undertaken to the Appellant. A~~ a visit was therefore arranged for 11 June 2019 at the Appellant's accountant's office (Younique Accountancy Limited, Cobalt Business Exchange, Cobalt Park Way, Newcastle upon Tyne NE28 9NZ) ("Younique")). This visit was then allocated to Officer Jeffares, the decision-making officer. Kelly Boot (a senior accountant) and Neil Day (the director of Younique) were present but Mr Stewart Day (the director of the Appellant) was not. The nature of the business was discussed and it was confirmed that Younique completed the VAT returns. It was established that the Appellant was acquired in December 2018 by TMG Swansea Limited (owned by Mr Stewart Day) with all previous directors resigning and Mr Stewart Day being appointed as sole director at the time of purchase. At this meeting

the two invoices from Westbridge that are the subject of the input tax denial were provided to Officer Jeffares (together 'The Denied Invoices').

14. The Denied Invoices subject of this appeal are:

    a. Invoice numbered 10010 dated 28 January 2019, issued by Westbridge to the Appellant, purportedly in respect of a *'Finders Fee relating to site being 10% of purchase price'* ("Finder's Fee Invoice"). The total invoice value was £408,000, of which £340,000 was for the finder's fee and £68,000 was VAT. The invoice provided a 'due date' of 13 March 2019.

    b. Invoice numbered INV-0012 dated 28 May 2019, issued by Westbridge to the Appellant, purportedly in respect of *'Site Management fees January – May inclusive'* ("Site Management Invoice"). The total invoice value was £60,000, of which £50,000 was for site management fees, charged at a rate of £10,000 per calendar month, and £10,000 was VAT. The invoice provided a 'due date' of 28 June 2019.

15. On 12th June 2019, Neil Day of Younique provided further information in respect of the Denied Invoices, and provided various documents including Land Registry documents, planning permissions and site reports, a facility agreement, and an acknowledgement of an option to tax dated 14 October 2015. Neil Day also provided the Appellant's bank account details, but confirmed that neither account had been used because all payments made by that date were made through a solicitor's account. In respect of certain documents provided:

    a. Land Registry documents related to: title number CYM455790, being Unit J, Trawler Road, Maritime Quarter, Swansea, SA1 1XA; and title number CYM701068, being land lying to the east of Boat Yard, Trawler Road, Maritime Quarter, Swansea. The Appellant is recorded as the registered proprietor of CYM455790 from 17 November 2014, and as the registered proprietor of CYM701068 from 21 December 2017.

    b. On 14 October 2015 the Respondents wrote to the Appellant acknowledging its option to tax in respect of its interest in land at Unit J, Trawler Road, Maritime Quarter, Swansea, SA1 1XA with effect from 1 August 2015.

c. Knights plc had produced a 'planning summary report' and a 'section 106 summary report', both dated 12 October 2018, *'For TMG Swansea Ltd purchase of AMW Estates Limited Site J, Trawler Road, Swansea Marina.'*

16. On 17 June 2019, in response to additional queries raised by Officer Jeffares, Neil Day of Younique stated that the finder's fee related to *'the site at Swansea which was acquired for £3.4 million.'*

17. Officer Jeffares considered the Denied Invoices from Westbridge and having checked departmental systems noted that it had been deemed to be a missing trader having not submitted any VAT returns since it was registered for VAT. HMRC had raised central assessments for a total of £40,430 none of which had been paid. Central Assessments had been raised for the VAT Periods 09/17, 12/17 and 03/18. As above, Westbridge would later declare outputs during those periods totalling £866,334, generating a VAT liability of £54,598. Westbridge failed to account for this VAT at the appropriate time, and never paid any VAT to the Respondents.

18. On 3 July 2019, in response to further queries raised by Officer Jeffares, Neil Day of Younique provided a funds instruction letter dated 17 December 2018, directing the payment of £403,504.23 to Westbridge. Neil Day also stated that the Finder's Fee Invoice was 'for finding site in Swansea and liaising / negotiating acquisition' and the Site Management Invoice was for 'site management fees for them to look after the site and they will project manage the build.'

19. By letter dated 24 July 2019, the Respondents notified the Appellant that a decision had been taken to refuse the company's entitlement to the right to deduct input tax, totalling £78,000, in connection with transactions during the 05/19 period (**Appendix 1**).

20. The letter referred to the European Court of Justice's judgments in the case of I/*S Fini H* (C-32/03) and in the joined cases of *Axel Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL* (C-439/04 and C440/04), and stated that:

> *'The Commissioners are satisfied that you have exercised the right to deduct upon the transactions set out below for fraudulent or abusive ends. Alternatively the Commissioners are satisfied that those transactions were connected with the fraudulent evasion of VAT and that you know or should have known that this was the case.*

Accordingly your claim to input tax in respect of these transactions is denied.'

~~21. The reasons given by the Respondents were set out in the letter and are expanded upon in the Respondents' submissions at paragraphs 40 to 45 below.~~

22. On 16 August 2019 ~~the Appellant's accountants~~ Neil Day of Younique wrote to Officer Jeffares requesting further clarification as to the reasons for the decision and explaining that the Appellant was aware that Westbridge was behind in providing its VAT returns and would make sure that these were brought up to date within 28 days. Neil Day confirmed that *'Westbridge Associates Limited is an associated company that provided services of finding Unit J Swansea, liaising/negotiating the acquisition and the management of the site. It raised two invoices for its services, one dated 28 January 2019 for £68,000 VAT and 28 May 2019 for £10,000 of VAT.'* Neil Day provided a solicitor's financial ledger, and identified the following payments:

a. In respect of the Finder's Fee Invoice, against a total invoice value of £408,000, a sum of £403,504.23 was paid on 17 December 2018.

b. In respect of the Site Management Invoice, against a total invoice value of £60,000, a sum of £9,774.99 was paid on 14 February 2019.

23. No further evidence of payment to Westbridge in respect of the Denied Invoices has been provided. As above, in its Grounds of Appeal the Appellant states: *'WAL has been paid the 'net' fees charged to AMW but the VAT element has not yet been settled by its customer.'* The total value of the payments shown in the solicitor's financial ledger is £413,279.22. The total net value of the invoices is £390,000.

24. A response was provided by Officer Jeffares on 23 August 2019. He also indicated that he would be allowing the remainder of the repayment from the 05/19 return (excluding the £78,000 that had been denied).

25. On 17 September 2019 pursuant to section 69C of the Value Added Tax Act 1994 the Appellant was assessed for a penalty based on the transactions denied in the decision of 24 July 2019 (**Appendix 2**).

26. By way of a letter dated 14 October 2019 ~~the Appellant requested a review of the decision of 24 July 2019 and 17 September 2019.~~ Neil Day of Younique requested a review of the decision to deny the Appellant's right to claim input tax on the Denied Invoices from Westbridge. That letter stated, amongst other things:

a. *'AMW has purchased Unit J Swansea, which it intends to develop into student accommodation and sell either the freehold or a leasehold of 21 years or more.'*

b. *'Westbridge Associates Limited (WAL) provided services of finding Unit J Swansea, liaising/negotiating the acquisition and the management of the site. It raised two invoices for its services, one dated 28 January 2019 for £340,000 plus £68,000 VAT and 28 May 2019 for £50,000 plus £10,000 of VAT.'*

c. *'AMW has paid £403,504.32 of the invoice dated 28 January 2019 and £9,774.99 of the invoice dated 28 May 2019.'*

d. *'Therefore, VAT of £67,250.72 has been paid in regard to the invoice dated 28 January 2019 and VAT of £1,629.17 has been paid regarding the invoice dated 28 May 2019.'*

e. *'AMW has paid £68,879.89 of the £78,000 VAT due to WAL.'*

f. *'WAL may be guilty of careless behaviour for not having submitted its VAT returns on time. Mr Stewart Day is the director of several companies and has been occupied in the day to day running of these businesses which is why he has let the VAT returns become overdue. However, this is not a fraudulent act and we are now in the process of bringing these outstanding VAT returns up to date.'*

g. *'AMW has paid £68,879.89 of the output tax due (£78,000) and only £9,120.11 is currently outstanding.'*

27. As above, on 9 November 2019 Westbridge finally submitted outstanding VAT Returns for its trading history. These showed previously undeclared outputs of £2,186,334, and a VAT liability owing to the Respondents of £318,364.06. None of that tax has ever been paid to the Respondents. For the avoidance of any doubt, none of the £68,879.89 allegedly paid to Westbridge by the Appellant was ever paid over to the Respondents.

28. The Respondents undertook the requested review but by a decision dated 27 November 2019 they upheld the decision to deny the Appellant's input tax in the sum of £78,000 and the decision to assess the Appellant for a penalty in the sum of £23,400 although it was accepted that a 10% mitigation should be applied given the assistance provided by the Appellant and the penalty was reduced to £21,060 (**Appendix 3**).

LEGAL FRAMEWORK

The right to deduct input tax

29. Under Community law, the right to deduct input tax from the VAT that a taxable person is liable to pay is contained in Articles 167 and 168 of Council Directive 2006/112/EC of 278 November 2006 on the common system of VAT, which provide:

> *"**Article 167***
>
> *The right of deduction shall arise at the time the deductible tax becomes charged.*
>
> *...*
>
> ***Article 168***
>
> *In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:*
>
> *(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person.*
>
> *..."*

30. Sections 24, 25 and 26 of the VAT Act 1994 provide:

> *"**24 Input tax and output tax***
>
> *(1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—*
>
> *(a) VAT on the supply to him of any goods or services;*
>
> *(b) VAT on the acquisition by him from another member State of any goods; and*
>
> *(c) VAT paid or payable by him on the importation of any goods from a place outside the member States,*
>
> *being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.*
>
> *...*
>
> ***25 Payment by reference to accounting periods and credit for input tax against output tax***
>
> *(1) A taxable person shall—*
>
> *(a) in respect of supplies made by him, and*

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

account for and pay VAT by reference to such periods (in this Act referred to as "prescribed accounting periods") at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

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

…

26 Input tax allowable under section 25

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

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

(a) taxable supplies;

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

(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of the subsection.

…"

31. Regulation 29 of the VAT Regulations 1995, as amended by the VAT (Amendment) Regulations, SI 2009/586, provides:

*"**29 Claims for input tax***

(1) Subject to paragraph (1A) below, and save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable save that, where he does not at that time hold the document or invoice required

by paragraph (2) below, he shall make his claim on the return for the first prescribed accounting period in which he holds that document or invoice.

…"

32. The effect of these provisions is that a taxable person may set allowable input tax against his output tax liability, thereby either reducing the amount of VAT that is due or, if the input tax credit exceeds the output tax liability, giving rise to a repayment.

Denial of the right to deduct input tax

33. The European Court of Justice ("ECJ") has held that the right to deduct input tax may be denied where it is relied on for fraudulent or abusive ends. In its judgment in *I/S Fini H* (C-32/03 – "*Fini*"), the ECJ stated at [32]–[34]:

> *"32. …the Court has already held that Community law cannot be relied on for abusive or fraudulent ends…*
>
> *33. If the tax authorities were to conclude that the right to deduct has been exercised fraudulently or abusively, they would be entitled to demand, with retrospective effect, repayment of the amounts deducted…*
>
> *34. It is, in any event, a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that this right is being relied on for fraudulent or abusive ends."*

34. The ECJ has also held that the right to deduct input tax may be denied where a taxable person knew or should have known that the transactions to which the claim for input tax relates were connected with the fraudulent evasion of VAT. In the joined cases *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04 – "*Kittel*"), the ECJ stated at [56]–[59]:

> *"56. … a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.*
>
> *57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.*
>
> *58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.*

59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'."

35. The principles set out in *Kittel* and *Fini* have been further considered in a series of domestic decisions. In *Mobilx Ltd (in Administration) v HMRC* [2010] EWCA Civ 517 ("*Mobilx*"), Moses LJ stated at [52]:

> *52. "If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in Kittel. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."*

36. Specifically, looking at the two principles, Moses LJ stated at [35]-[36] and [41]:

> *35."From § 53-55 in Kittel the Court set out the starting point for its development of the principles relating to cases where the taxable person was himself acting fraudulently:-*
>
> *"53. By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity' are not met where tax is evaded by the taxable person himself (see Case C-255/02 Halifax and Others [2006] ECR I-0000, paragraph 59).*
>
> *54. As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 Gemeente Leusden and Holin Groep [2004] ECR I-5337, paragraph 76). Community law cannot be relied on for abusive or fraudulent ends (see, inter alia, Case C-367/96 Kefalas and Others [1998] ECR I-2843, paragraph 20; Case C-373/97 Diamantis [2000] ECR I-*

1705, paragraph 33; and Case C-32/03 Fini H [2005] ECR I-1599, paragraph 32).

55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 Rompelman [1985] ECR 655, paragraph 24; Case C-110/94 INZO [1996] ECR I-857, paragraph 24; and Gabalfrisa, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see Fini H, paragraph 34)."

36.The Court's reference, in § 55, to a quartet of previous decisions reinforces the proposition that fraudulent tax evasion falls outwith the scope of VAT and thus the scope of the right to deduct input tax. Fraudulent evasion of tax does not meet the objective criteria, such as whether the activity is "economic activity" or a taxable person is "acting as such", by which the scope of VAT and of the right to deduct are identified.

41. In Kittel after § 55 the Court developed its established principles in relation to fraudulent evasion. It extended the principle, that the objective criteria are not met where tax is evaded, beyond evasion by the taxable person himself to the position of those who knew or should have known that by their purchase they were taking part in a transaction connected with fraudulent evasion of VAT:-

"56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them."

59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the

taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'. [emphasis added]"

The words I have emphasised "in the same way" and "therefore" link those paragraphs to the earlier paragraphs between 53-55. They demonstrate the basis for the development of the Court's approach. It extended the category of participants who fall outwith the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. Kittel did represent a development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct.

37. Considering the requirement that a taxable person knew or should have known that transactions were connected with the fraudulent evasion of VAT, Moses LJ stated at [59]–[60]:

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

60. The true principle to be derived from Kittel does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant

where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

38. Considering questions of proof, Moses LJ stated at [81] "that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion." He went on at [82] to state:

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

39. At [83], Moses LJ affirmed guidance on the treatment of circumstantial evidence in such cases that had been set out by Christopher Clarke J in *Red 12 v HMRC* [2009] EWHC 2563, as follows:

> *"109 Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.*
>
> *110 To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may*

be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.

111 Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

40. In *Fonecomp Ltd v HMRC [2015] EWCA Civ 39*, Arden LJ confirmed at [45] that "there is nothing in Kittel which would lead to the conclusion that HMRC has to show that the transaction provides tangible assistance in carrying out the fraud." She went on at [48] to state that:

> *"Lack of knowledge of the specific mechanics of a VAT fraud affords no basis for any argument that the decision of either tribunal was wrong in law: what is required is simply participation with knowledge in a transaction 'connected with fraudulent evasion of VAT'…*"

41. Considering *Mobilx* in particular, she went on at [51] to state that:

> *"However, in my judgment, the holding of Moses LJ does not mean that the trader has to have the means of knowing how the fraud that actually took place occurred. He has simply to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some transaction to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge. This is apparent from [56] and*

[61] of Kittel *cited above. Paragraph 61 of* Kittel *formulates the requirement of knowledge as knowledge on the part of the trader that 'by his purchase he was participating in a transaction connected with fraudulent evasion of VAT'. It follows that the trader does not need to know the specific details of the fraud."*

42. In *AC (Wholesale) Ltd v HMRC [2017] UKUT 191 (TCC),* the Upper Tribunal considered *Mobilx* and stated that "…the 'only reasonable explanation' test is simply one way of showing that a person should have known that transactions were connected to fraud." The Upper Tribunal went on to state that:

> *"29. It is, to us, inconceivable that Moses LJ's example of an application of part of that test, the 'no other reasonable explanation', would lead to the test becoming more complicated and more difficult to apply in practice. That, in our view, would be the consequence of applying the interpretation urged upon us by Mr. Brown. In effect, HMRC would be required to devote time and resources to considering what possible reasonable explanations, other than a connection with fraud, might be put forward by an appellant and then adduce evidence and argument to counter them even where the appellant has not sought to rely on such explanations. That would be an unreasonable and unjustified evidential burden on HMRC. Accordingly, we do not consider that HMRC are required to eliminate all possible reasonable explanations other than fraud before the FTT is entitled to conclude that the appellant should have known that the transactions were connected to fraud.*
>
> *30. Of course, we accept (as, we understand, does HMRC) that where the appellant asserts that there is an explanation (or several explanations) for the circumstances of a transaction other than a connection with fraud then it may be necessary for HMRC to show that the only reasonable explanation was fraud. As is clear from Davis & Dann, the FTT's task in such a case is to have regard to all the circumstances, both individually and cumulatively, and then decide whether HMRC have proved that the appellant should have known of the connection with fraud. In assessing the overall picture, the FTT may consider whether the only reasonable conclusion was that the purchases were connected with fraud. Whether the circumstances of the transactions can reasonably be regarded as having an explanation other than a connection with fraud or the existence of such a*

connection is the only reasonable explanation is a question of fact and evaluation that must be decided on the evidence in the particular case. It does not make the elimination of all possible explanations the test which remains, simply, did the person claiming the right to deduct input tax know that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT or should he have known of such a connection."

Burden and standard of proof

43. The Respondents acknowledge that they bear the burden of proving that the transactions in question were without the scope of the right to deduct input tax. In *Mobilx & Others*, Moses LJ stated at [82]:

> *'It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion....But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant...'*

44. The standard of proof is the civil standard of the balance of probabilities, there no longer being a 'heightened civil standard'. In *Re B* [2009] 1 AC 11, Lord Hoffman stated at [13] that, '*I think that the time has come to say, once and for all, that there is only one civil standard of proof, and that is proof that the fact in issue more probably occurred than not*'.

Penalties

45. Section 69C of the VAT Act 1994 states as follows:

> ***69C Transactions connected with VAT fraud***
>
> *(1) A person (T) is liable to a penalty where—*
>
> *(a) T has entered into a transaction involving the making of a supply by or to T ("the transaction"), and*
>
> *(b) conditions A to C are satisfied.*
>
> *(2) Condition A is that the transaction was connected with the fraudulent evasion of VAT by another person (whether occurring before or after T entered into the transaction).*

(3)Condition B is that T knew or should have known that the transaction was connected with the fraudulent evasion of VAT by another person.

(4)Condition C is that HMRC have issued a decision ("the denial decision") in relation to the supply which—

(a) prevents T from exercising or relying on a VAT right in relation to the supply,

(b) is based on the facts which satisfy conditions A and B in relation to the transaction, and

(c) applies a relevant principle of EU case law (whether or not in circumstances that are the same as the circumstances in which any relevant case was decided by the European Court of Justice).

(5) In this section "VAT right" includes the right to deduct input tax, the right to apply a zero rate to international supplies and any other right connected with VAT in relation to a supply.

(6) The relevant principles of EU case law for the purposes of this section are the principles established by the European Court of Justice in the following cases—

(a) joined Cases C-439/04 and C-440/04 Axel Kittel v. Belgian State; Belgium v. Recolta Recycling (denial of right to deduct input tax), and

(b) Case C-273/11 (b) Mecsek-Gabona Kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága (denial of right to zero rate), as developed or extended by that Court (whether before or after the coming into force of this section) in other cases relating to the denial or refusal of a VAT right in order to prevent abuses of the VAT system.

(7) The penalty payable under this section is 30% of the potential lost VAT.

(8) The potential lost VAT is—

(a) the additional VAT which becomes payable by T as a result of the denial decision,

(b) the VAT which is not repaid to T as a result of that decision, or

(c) in a case where as a result of that decision VAT is not repaid to T and additional VAT becomes payable by T, the aggregate of the VAT that is not repaid and the additional VAT.

(9) Where T is liable to a penalty under this section the Commissioners may assess the amount of the penalty and notify it to T accordingly.

(10) No assessment of a penalty under this section may be made more than two years after the denial decision is issued.

(11) The assessment of a penalty under this section may be made immediately after the denial decision is made (and notice of the assessment may be given to T in the same document as the notice of the decision).

(12) Where by reason of actions involved in making a claim to exercise or rely on a VAT right in relation to a supply T—

(a) is liable to a penalty for an inaccuracy under paragraph 1 of Schedule 24 to the Finance Act 2007 for which T has been assessed (and the assessment has not been successfully appealed against by T or withdrawn), or

(b) is convicted of an offence (whether under this Act or otherwise), those actions do not give rise to liability to a penalty under this section.]

ISSUES

46. The issues to be determined are as follows:

a. whether the right to deduct input tax had been relied upon for fraudulent or abusive ends; or, alternatively,

b. whether the transactions with respect to which the right to deduct input tax was denied were connected with the fraudulent evasion of VAT, and that the Appellant knew, or should have known, that that was the case. Specifically:

i. whether there was a tax loss;

ii. whether that tax loss due to fraudulent evasion;

iii. whether the transactions in question were connected to the tax loss; and

iv. whether the Appellant knew, or should have known, that that was the case.

RESPONDENTS' CASE

~~*Denial of Input Tax*~~
Westbridge

47. Westbridge registered for VAT with effect from 27 June 2017. Thereafter, it singularly failed to account for, or pay, VAT on taxable supplies it made. Despite reportedly generating outputs exceeding £2 million during approximately two years' trading, it failed to declare any of that trade to the Respondents until 9 November 2019, nearly 4 months after the Respondents' decision to refuse the Appellant's right to claim input tax in respect of supplies purportedly received from Westbridge. Westbridge has never paid any VAT to the Respondents. Westbridge's VAT debt stands at £318,364.06. Westbridge failed to notify the Respondents, either adequately or at all, of any innocent reason underlying its total non-compliance, or request further time to pay outstanding liabilities. In all the circumstances, the only reasonable inference is that Westbridge deliberately failed to comply with its obligations to account for, or pay, VAT. That conduct is dishonest

48. Of the £318,364.06 VAT owed by Westbridge to the Respondents, £78,000 was charged as output tax on supplies made to the Appellant, namely the supplies subject of the Finder's Fee Invoice and Site Management Invoice. That VAT was not accounted for at the appropriate time. That VAT has never been paid. The supplies subject of this appeal are therefore connected to a loss of tax. By reason of Westbridge's deliberate failure to comply with its VAT obligations, that tax loss is fraudulent.

49. Mr Stewart Day was the sole director of Westbridge throughout the whole of that company's trading period. He knew, because he must have known, that Westbridge had repeatedly failed to comply with its VAT obligations.

50. Insofar as it is alleged that Westbridge intended to account for and pay output tax in respect of the Denied Invoices, that allegation is inconsistent with the behaviour of Westbridge throughout all previous periods of its trading, and is further undermined by Westbridge's later failures to account for any VAT until 9 November 2019 or pay any of its VAT liabilities at any time. In all the circumstances, the only reasonable inference is that at the time the Denied Invoices were issued, Westbridge knew it would not account for, or pay, the associated output tax.

51. In respect of payments received by Westbridge from the Appellant for the Denied Invoices:

    a. Insofar as it is alleged, as asserted in the Appellant's Grounds of Appeal, that Westbridge has received payment of all but the VAT element of the Denied

Invoices, the likelihood that any alleged 'cash-flow' problems resulted in an insufficiency of funds in an amount equal to the VAT element is so small as to be capable of being discounted. Any alleged failure to demand or retain funds sufficient to discharge its output tax liabilities is consistent with Westbridge's knowledge that it would neither account for or pay that VAT.

b. Insofar as it is alleged, as asserted by Neil Day of Younique, that Westbridge received a payment from the Appellant of £403,504.23 on 17 December 2018 as against the Finder's Fee invoice total value of £408,000, there is no reasonable explanation consistent with honesty for Westbridge's failure to pay to the Respondents any amount of VAT received by it in respect of the Finder's Fee Invoice.

c. Insofar as it is alleged, as asserted by Neil Day of Younique, that Westbridge received payments from the Appellant in the total sum of £413,279.22 on 17 December 2018 and 17 February 2019 against a total net invoice value of £390,000, there is no reasonable explanation consistent with honesty for Westbridge's failure to pay to the Respondents any sums received by it exceeding the total net value of the Finder's Fee Invoice and the Site Management Invoice.

d. Insofar as it is alleged, as asserted by Neil Day of Younique, that Westbridge received a total of £68,879.89 in respect of output tax on supplies made to the Appellant by, at the latest, 17 February 2019, there is no reasonable explanation consistent with honesty for the failure of Westbridge to account for that output tax at the appropriate time, or the failure of Westbridge to pay that sum to the Respondents at all.

The Appellant

52. At the time that the Denied Invoices were issued, Stewart Day was the sole director of both the Appellant and Westbridge. The only reasonable inference is that through this common sole director, Stewart Day, the Appellant acted in full knowledge of Westbridge's financial circumstances and VAT affairs, including its ongoing deliberate defaulting behaviour, its failure to account for or pay any output tax on the Denied Invoices, and its future intentions.

53. On the date that the Appellant submitted the VAT repayment claim subject of this appeal for its 05/19 VAT Period, its sole director, Stewart Day, knew, because he must have known, the following:

    a. The Appellant's immediate supplier, Westbridge, had failed to account for, or pay, any VAT on taxable supplies it had made from the 09/17 VAT period onwards.

    b. The Appellant's immediate supplier, Westbridge, had failed to account for, or pay, any output tax on the purported supplies to the Appellant.

    c. Insofar as the same is alleged, as asserted by Neil Day of Younique, the Appellant had, by 17 February 2019 at the latest, paid to Westbridge the sum of £68,879.89 in respect of output tax on the Denied Invoices.

    d. Further, and insofar as the same is alleged, Westbridge had not accounted for, or paid, any of that £68,879.89 received from the Appellant in respect of output tax on the invoices.

54. As above, in light of Westbridge's failure to comply with its VAT obligations, the only reasonable inference is that at the time the Appellant submitted its 05/19 VAT Return Westbridge knew that it would not account for, or pay, the associated output tax on the Finder's Fee Invoice or Site Management Invoice. Through its sole director, Stewart Day, the Appellant must also have known that.

55. Further, to the extent that the Appellant relies upon its Grounds of Appeal that the Appellant paid to Westbridge the net value of the Denied Invoices, the chance that alleged 'cash-flow' issues resulted in an insufficiency of funds in an amount equal to the VAT element of the those invoices is so unlikely as to be capable of being discounted. Any underpayment by the Appellant of an amount equal to the VAT element of the Denied Invoices is consistent with knowledge on the part of the Appellant that Westbridge would not account for, or pay, the associated output tax to the Respondents. Further, the Appellant has failed to provide any adequate explanation, whether before or after the decision to deny its right to claim input tax, of the timing or nature of the alleged 'cash flow' problems.

The Denial

56. In the circumstances, the Appellant entered into transactions that were connected to the fraudulent evasion of VAT arising from Westbridge's repeated and deliberate failure to comply with its VAT obligations. Through its sole director, Stewart Day, the Appellant knew, because it must have known, of that connection. The Appellant's entitlement to the right to deduct input tax was therefore properly disallowed applying the principle in ***Kittel***, which permits refusal of the right to deduct when a taxpayer knows that its transactions are connected to a fraudulent loss of VAT.

57. Further and in the alternative:

    a. The Appellant submitted an input tax repayment claim knowing, through Stewart Day, that its supplier, Westbridge, a company of which Stewart Day was also a director, had not paid and would not pay the corresponding output tax.

    b. By submitting an input tax repayment claim in those circumstances, the Appellant, through Stewart Day, knew that the Respondents would suffer a loss of tax as a result of its input tax claim.

    c. That loss of tax arose when Westbridge, under the directorship of Stewart Day, failed to account for or pay to the Respondents the associated output tax on those same supplies.

    d. Insofar as it is alleged that work commitments led Stewart Day, as director of Westbridge, to neglect submission of Westbridge's VAT returns, those same work commitments did not prevent Stewart Day, as director of the Appellant, from ensuring that an input tax repayment claim was submitted in respect of supplies received from Westbridge.

58. In light of the common, sole directorship of the Appellant and Westbridge at the time of the Denied Invoices and the denied input tax repayment claim, the knowledge and motives of one cannot sensibly be distinguished from the other. In all of the circumstances, the Appellant exposed the Respondents to a tax loss by submitting an input tax repayment claim in respect of supplies from an associated company, Westbridge, which would fail to account for or pay output tax on the same supplies. In the premises, the Appellant's conduct in submitting an input tax repayment claim was dishonest. The Appellant's entitlement to the right to deduct input tax was therefore properly disallowed applying the principle in ***Fini***, which permits refusal of the right to deduct when that right is relied on for fraudulent ends.

59. The Respondents' case is that, with respect to purchases made from Westbridge, the Appellant relied upon the right to deduct input tax for fraudulent or abusive ends.

60. In support of this contention, the Respondents rely, in particular, on the following:

a. Through their common director and shareholder, it can be inferred that the Appellant and Westbridge must have acted in full knowledge of the other, including the other's intentions, its financial circumstances and, for example, sums paid or owing to the Respondents.

b. The Appellant's reliance in its notice of appeal on a claimed cash-flow problem depends on it having been an innocent coincidence that the cash-flow problem would give rise to an underpayment by the Appellant to Westbridge almost exactly equal to the output tax on the transactions, thereby allowing Westbridge to cover all of its outgoings except for the VAT owed to the Respondents. In all the circumstances of the case, the Respondents submit that this is not credible.

c. The existence of a cash-flow problem would not, in itself, explain why none of the funds passed from the Appellant to Westbridge, over several months, were used to pay any of the VAT owed by Westbridge to the Respondents.

d. The Appellant's reliance on a cash-flow problem also implies that it was an innocent coincidence that the alleged cash-flow problem coincided with the creation of the Appellant and the decision for it to trade with Westbridge (also owned by the same director). In all the circumstances of the case, the Respondents submit that this is not credible.

e. Before its notice of appeal, the Appellant had not, so far as the Respondents are aware, previously made reference to any cash-flow problem, including during its communications with Officer Jeffares. Even at this stage, the Appellant has provided few details.

f. Similarly, so far as the Respondents are aware, Westbridge did not contact the Respondents to inform them that the company would be unable to make its VAT payments or to request additional time to pay.

g. In light of the above, the Respondents submit that a cash-flow problem cannot, in itself, plausibly account for the facts underlying the decision to deny the Appellant's claim for input tax.

h. Irrespective of any cash flow problem, the Respondents submit that it can be reasonably inferred from all the circumstances of the case that the Appellant intentionally underpaid Westbridge by an amount approximately equal to the output tax that would be due on the transactions, in the knowledge that Westbridge would not then pay the output tax due on the transactions to the Respondents.

i. Further the fact that the fees charged by Westbridge to the Appellant were standard commercial fees does not affect the conclusion that the transactions in question were undertaken for fraudulent or abusive ends.

j. In such circumstances, the Respondents submit that to claim the right to deduct input tax for the transactions in question is to do so for fraudulent or abusive ends.

61. Alternatively, the Respondents submit that the transactions for which the Appellant's right to deduct input tax was denied were connected with the fraudulent evasion of VAT, and that the Appellant knew, or should have known, as much.

62. In support of this contention, the Respondents rely on the same facts and inferences as set out at paragraph 41 above. In particular:

a. Westbridge's failure to submit VAT returns and pay the VAT due to the Respondents. The fact that it has now, after the event, submitted those returns is irrelevant especially as no payment has been made.

b. The Respondents submit that the tax loss caused by Westbridge's default was due to fraudulent evasion and relies, in support, on the features set out at paragraph 41 above.

c. Westbridge's tax loss arose from a failure to pay output tax on the transactions for which the Appellant's right to deduct input tax was refused. Those transactions are therefore connected with the tax loss.

d. Through the common directors of the two companies, the Appellant must have known, or ought to have known, that the transactions in question were connected to the fraudulent tax losses attributable to Westbridge.

~~63. The Respondents therefore submit that input tax was correctly denied on one or both of the bases set out above.~~

Penalty

64. The Appellant further contests the penalty assessment that it has been issued. It is submitted that the penalty was made under section 69C of the VAT Act 1994. This provides for the assessment of a penalty for transactions connected with VAT fraud where it can be established that the business knew or should have known that its transactions were connected with VAT fraud. In such circumstances a penalty will be charged at 30% of the VAT amount denied. For the reasons set out above the Respondents submit that the Appellant knew ~~or should have known~~ that the transactions were connected with VAT fraud and that as such the penalty was correctly assessed.

CONCLUSION

65. For the reasons given, it is respectfully submitted that the appeal ought to be dismissed."