Neutral Citation: [2022] UKFTT 224 (TC)

Case Number: TC08546

FIRST-TIER TRIBUNAL
TAX CHAMBER

At Centre City Tower, Birmingham

Appeal reference: TC/2018/3239

VAT *– Denial of input tax under the Kittel principle — whether appellant knew or should have known that the only reasonable explanation for the transactions was that they were connected with fraud - assessment of output tax under the Mecsek principle – whether the appellant knew or should have known that the transactions were part of a tax fraud committed by its purchaser, and that it had not taken every reasonable step within its power to prevent its own participation in that fraud*

Heard on: 28 March to 4 April 2022
Judgment date: 20 July 2022

Before

TRIBUNAL JUDGE PETER KEMPSTER
Mr TERENCE BAYLISS

Between

LYNTON EXPORTS (ALSAGER) LIMITED

Appellant

and

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: David Bedenham of counsel, instructed by Vincent Curley & Co Ltd

For the Respondents: Joanna Vicary and Matthew Howarth of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. By an assessment dated 28 December 2017 the Respondents ("**HMRC**") denied the claim by the Appellant ("**the Company**") to deduct input tax of £426,444 in respect of VAT periods 12/15 and 01/16. By a further assessment dated 20 February 2018 HMRC denied the Company's claim to deduct input tax of £5,436,885 in respect of the VAT periods 11/15 to 10/16. For both assessments (together "**the Kittel Assessments**") the Company's right to deduct input tax was denied on the basis that the relevant transactions were connected with a scheme to defraud the Treasury of VAT, and the Company knew, or should have known, that this was the case – pursuant to "**the Kittel Principle**" (see [8-11] below).

2. By an assessment dated 28 December 2017 HMRC assessed the Company to output tax in the sum of £361,446 in respect of VAT periods 12/15 and 01/16. By a further assessment dated 20 February 2018 HMRC assessed the Company to output tax in the sum of £4,464,037 in respect of VAT periods 11/15 to 10/16. For both assessments (together "**the Mecsek Assessments**") the Company's claim to zero rating of the relevant transactions was denied on the basis that the relevant transactions were connected with a scheme to defraud the Treasury of VAT, and the Company knew, or should have known, that this was the case – pursuant to "**the Mecsek Principle**" (see [12-15] below).

3. All of the above assessments (together "**the Disputed Assessments**") were considered and upheld on formal internal review by HMRC, with the conclusions of the reviewing officer being notified to the Company on 30 April 2018. By Notice of Appeal dated 17 May 2018 the Company now appeals the Disputed Assessments to the Tribunal.

THE HEARING

4. The hearing took place over six days in a double courtroom with HMCTS provision for appropriate distancing. Transcribers were present for days 2 to 5 of the hearing, and overnight transcripts were provided to both parties and the Tribunal panel.

5. There was a large number of bundles of documentary evidence, which was also made available in electronic format. We heard oral evidence in person from the following witnesses who all gave evidence under oath or affirmation, and were available for cross-examination:

(1) For the Company:

(a) Mr Robert Sandell is a director of the Company, and had particular involvement with the transactions relevant to the Disputed Assessments. He adopted and confirmed two witness statements dated 14 October 2019 and 29 January 2021.

(b) Mr David Sandell is the founder of and a director of the Company, and the father of Robert Sandell. He adopted and confirmed a witness statement dated 29 January 2021.

(2) For HMRC:

(a) Mr Stephen Mills is the HMRC officer who issued the Disputed Assessments. He adopted and confirmed a witness statement dated 14 May 2019.

(b) Ms Lisa Wilkinson is the HMRC officer who was the case officer for a supplier to the Company: Wholesale Distribution Limited. She adopted and confirmed a witness statement dated 14 May 2019. (Ms Wilkinson also adopted

and confirmed a further witness statement also dated 14 May 2019 concerning another taxpayer, Whitmount Limited, on which she was not cross-examined.)

6. The evidence bundles also contained witness statements provided by a number of other HMRC officers, concerning other traders in the chains of transactions relevant to the Disputed Assessments. These were not challenged by the Company and we have considered them only as background to HMRC's decision to issue the Disputed Assessments.

RELEVANT LAW

MTIC Fraud

7. HMRC contend that the transactions relevant to the Disputed Assessments were involved in missing trader intra-community ("**MTIC**") fraud. The features of MTIC fraud have been described in various decision of this Tribunal and the courts, and we respectfully adopt the explanation given by Christopher Clarke J in *Red 12 Trading Ltd v RCC* [2010] STC 589 at [1-10] – set out in Appendix One to this decision notice.

The Kittel Principle

8. It is well established that "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 … 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 …" per the CJEU in *Kittel v Belgium* [2008] STC 1537 ("***Kittel***") (at [55]). Moreover, this refusal extends beyond the obvious fraudster (the "defaulter", in *Red 12* terminology), per *Kittel*:

> "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."

9. That extension was examined by the Court of Appeal in *Mobilx Ltd v RCC* [2010] STC 1436 ("***Mobilx***"), as explained by Proudman J in *GSM Export (UK) Ltd v RCC* [2014] UKUT 529 (TCC) at [16]:

> "In *Mobilx*, Moses LJ said at [59] that the test in *Kittel*'s case was "simple and should not be over-refined". Three key points were mentioned as to the required state of mind of the taxpayer:
>
> a. "Should have known" means "knowing or having any means of knowing"; at [51];
>
> b. The taxpayer should have known (or the taxpayer had the means of knowing) that the transaction was connected with fraudulent evasion of VAT; it is not sufficient to know or to have the means of knowing that there was a risk that the transaction might have been so connected (at [56]) or that it was "more likely that not" that the transaction was so connected; at [59]; and
>
> c. A taxpayer can be regarded as being in a position where he should have known that the transaction was connected with fraudulent evasion of VAT where he should have known that "the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud"; at [59] and [60]."

10. In *Fonecomp Ltd v HMRC* [2015] STC 2254 the Court of Appeal confirmed that a trader does not need to know the specific details of the fraud being perpetuated. Arden LJ stated (at [51]):

> "… 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 paras 56 and 61 of *Kittel* cited above. Paragraph 61of *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."

11. The "only reasonable explanation" requirement was considered by the Upper Tribunal in *AC (Wholesale) Ltd v HMRC* [2017] UKUT 191 (TCC):

> "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 [Counsel for taxpayer]. 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.
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> 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* [[2016] STC 126], 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."

The Mecsek Principle

12. Article 138(1) Principal VAT Directive 2006/112/EEC provides for the exemption of supplies of goods between traders in different member states. The UK enacted that as a zero-rating provision (ie "exemption with full reclaim") by s 30(8) VAT Act 1994 ("**VATA 1994**"):

> "Regulations may provide for the zero-rating of supplies of goods, or of such goods as may be specified in the regulations, in cases where—
>
> (a) the Commissioners are satisfied that the goods have been or are to be exported to such places as may be specified in the regulations, and
>
> (b) such other conditions, if any, as may be specified in the regulations or the Commissioners may impose are fulfilled."

13. That is enacted in those terms by reg 134 VAT Regulations 1995, SI 1995/2518.

14. In *Mecsek-Gabona Kft v Nemzeti Ado-es Vamhivatal Del-dunantuli Regionalis Ado Foigazgatosaga* [2012] EUECJ C-273/11 ("***Mecsek***") a Hungarian exporter was denied relief from VAT on an export of goods to an Italian customer who was alleged to be fraudulent. The CJEU stated:

> "53 … the Court has no jurisdiction to check or to assess the factual circumstances of the case before the referring court. It is therefore for the national court to carry out an overall assessment of all the facts and circumstances of the case in order to establish whether Mecsek-Gabona had acted in good faith and taken every step which could reasonably be asked of it to satisfy itself that the transaction which it had carried out had not resulted in its participation in tax fraud.
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> 54 If the referring court were to reach the conclusion that the taxable person concerned knew or should have known that the transaction which it had carried out was part of a tax fraud committed by the purchaser and that the taxable person had not taken every step which could reasonably be asked of it to prevent that fraud from being committed, there would be no entitlement to exemption from VAT.
>
> 55 … Article 138(1) of Directive 2006/112 is to be interpreted as not precluding, in circumstances such as those of the case before the referring court, refusal to grant a vendor the right to the VAT exemption for an intra-Community supply, provided that it has been established, in the light of objective evidence, that the vendor has failed to fulfil its obligations as regards evidence, or that it knew or should have known that the transaction which it carried out was part of a tax fraud committed by the purchaser, and that it had not taken every reasonable step within its power to prevent its own participation in that fraud."

15. In *Schoenimport "Italmoda" Mariano Previti* [2014] EUECJ C-131/13 ("***Italmoda***") the CJEU stated:

> "49 … it is, in principle, the responsibility of the national authorities and courts to refuse the benefit of the rights laid down by the Sixth Directive when they are claimed fraudulently or abusively, irrespective of whether those rights are rights to a deduction, to an exemption or to a VAT refund in respect of intra-Community supplies, as at issue in the case in the main proceedings.
>
> 50 … according to settled case-law, that is the position not only where tax evasion has been carried out by the taxable person itself but also where a taxable person knew, or should have known, that, by the transaction concerned, it was participating in a transaction involving evasion of VAT carried out by the supplier or by another trader acting upstream or downstream in the supply chain (see to that effect, inter alia, judgments in *Kittel* and *Recolta Recycling*, EU:C:2006:446, paragraphs 45, 46, 56 and 60, and *Bonik*, EU:C:2012:774, paragraphs 38 to 40).
>
> …

> 69 … the Sixth Directive must be interpreted as meaning that a taxable person who knew, or should have known, that, by the transaction relied on as a basis for rights to deduction of, exemption from or refund of VAT, that person was participating in evasion of VAT committed in the context of a chain of supplies, may be refused the benefit of those rights, notwithstanding the fact that the evasion was carried out in a Member State other than that in which the benefit of those rights has been sought and that taxable person has, in the latter Member State, complied with the formal requirements laid down by national legislation for the purpose of benefiting from those rights."

MATTERS IN DISPUTE

16. A number of points raised in pre-trial correspondence, pleadings and submissions before the Tribunal were resolved between the parties:

(1) The Company accepts that the Disputed Assessments were issued within the relevant time limits.

(2) The Disputed Assessments cover a total of 374 deals in the VAT periods 11/15 to 10/16.

(3) The amounts of the Disputed Assessments are the figures shown in Appendix Two to this decision notice.

(4) The goods in all the deals covered by the Disputed Assessments are soft drinks or confectionery.

(5) All the Kittel Assessments relate to purchases from a single supplier: Wholesale Distribution Limited ("**WDL**"). The Company accepts that all those trades can be traced to transactions connected with fraudulent evasion of VAT (but does not accept that it knew or should have known of such connections).

(6) All the Mecsek Assessments relate to sales to two customers in the Republic of Ireland: Swift Valley Trading Limited ("**Swift**") and PKC Wholesale ("**PKC**").

17. Two matters remain to be determined by the Tribunal.

18. First, in relation to the Kittel Assessments, did the Company know that the deals were connected with fraudulent evasion of VAT, or should the Company have known that the deals were connected with fraudulent evasion of VAT (which will be the case if it should have known that the only reasonable explanation for the deals was that they were connected with fraud)?

19. Secondly, in relation to the Mecsek Assessments, did the Company know or should it have known that the deals were part of a tax fraud, and that it had not taken every reasonable step within its power to prevent its own participation in that fraud? HMRC confirmed that they contend the fraudulent persons in question were the direct customers of the Company – namely, Swift and PKC – and, in these proceedings, they do not seek to argue the fraud of other persons (what in *Italmoda* at [50] were described as "another trader acting upstream or downstream in the supply chain") as relevant.

THE KITTEL ASSESSMENTS

20. HMRC submit there are numerous factors that point to the reasonable conclusion that the Company either knew that the deals were connected with fraudulent evasion of VAT, or should have known that the only reasonable explanation for the deals was that they were connected with fraud. HMRC accept they bear the burden of proof, to the standard of balance of probabilities, on that conclusion.

21. It is convenient to address those factors in turn below, together with the Company's counter-submissions and our findings from the evidence, but in reaching a conclusion our approach (which is uncontroversial) is to look at the picture formed by all the factors taken together. Focussing unduly on any one of the factors, or adopting some checklist approach, is not appropriate; it is the overall picture assessed from all the circumstances which is determinative. As the Upper Tribunal stated in *AC (Wholesale) Ltd v HMRC* [2017] UKUT 0191 (TCC) (at [30]): "As is clear from *Davis & Dann* [[2016] STC 1236], 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."

Experienced export trader adopts different business model with low margins, resulting in sudden and dramatic rise in turnover with small additional profit

22. HMRC submit:

(1) The Company was a long-established export trader, with a successful business involving the repacking of British speciality goods for export. The bulk sales of confectionery and soft drinks to the Republic of Ireland were a completely different type of business, with significantly lower margins. No satisfactory explanation had been given why the Company should choose to take on a completely different style of trade with little profit, which had proven to be linked to VAT fraud.

(2) For decades the Company had conducted its business as purchasing identifiably British goods and selling these to speciality shops abroad, often as mixed orders. None of that business was being challenged by HMRC. Around 2014 the Company decided to embark on a new venture of bulk sales of confectionery and soft drinks to customers in the Republic of Ireland; it had been explained to HMRC that the new business was handled by Robert Sandell, in contrast to the longstanding business which was overseen by his father, David Sandell.

(3) The turnover of the Company showed variations from year-to-year but when the sales of confectionery and soft drinks to the Irish customers were undertaken in 2016, this resulted in a doubling of the Company's turnover (from around £16 million to around £31 million). This should have been apparent as too good to be true. Also, this huge increase in sales produced only a very small increase in profit – around £50,000; the anomaly must have been obvious to the Company, which chose to ignore the fact and actively pursued these deals.

(4) In contrast to the existing business, which involved a significant number of different and varied suppliers and customers, the new business had only a single main supplier (WDL) and only two main customers (Swift and PKC).

(5) The extra turnover was not legitimately sourced. The supplier was WDL – a one-man company with a sole director (Mr Crothers), operating from a small retail shop using a mobile phone with no website or advertising. The due diligence report on WDL stated its annual turnover to be around £4 million, but the orders from the Company took this over £30 million yet the Company never took steps to check the legitimacy of this trading.

23. The Company submits:

(1) The Company has an established reputation in the grocery export industry, and is an exclusive export representative in certain jurisdictions for some well-known British brands, such as Branston Pickle, Jaffa Cakes, Tunnocks, and Twiglets.

(2) The Company has carried out straight wholesaling transactions, where it purchases and sells goods to order at a profit, for forty years, dealing with manufacturers, brand

owners, authorised distributors, buying groups, clearance houses, wholesalers, cash and carries and catering suppliers. This involves both standard rated confectionary and soft drinks and zero-rated food items In addition to wholesaling, the Company has trading partnerships with manufacturers where it not only purchases and sells their goods but also markets and promotes their goods in different marketplaces across the world. The deals covered by the Disputed Assessments were all straight wholesaling, and no different from what the Company has been doing for the forty years it has been in business. There was nothing unusual in the challenged deals; the commercial documents relating to all the challenged transactions are indistinguishable from the commercial documents that exist for all of the Company's trading activities.

(3) HMRC were correct that the new business involved entry to a potentially attractive new market; that was why it was misleading to compare margins with those achieved in the longstanding, existing export business. Robert Sandell understood there was huge demand in the Republic of Ireland for global brand products such as Red Bull, Snickers and Mars, and suspected that imports from the UK were necessary to meet the demand. This was the possibly lucrative market that he hoped to break into. The Republic of Ireland was the UK's largest export market. The Company had earlier made efforts to break into the Irish market but without success.

(4) HMRC have confirmed that they make no allegation of dishonesty against the Company. The Company was a long established and successful business; why would such a trader put its existence at risk for a small increase in profits?

24. Tribunal consideration:

(1) Mr Robert Sandell is the son of the effective proprietor of the Company, Mr David Sandell. Robert wished to expand the Company's trading into new areas, and we accept his evidence that he has been for some time considering the Irish market as a possible venture. It is accepted that the margins earned on the new business are much smaller than those enjoyed on the main business of the Company.

(2) From a careful examination of the documentary and oral evidence produced to us, we conclude that the differences between the longstanding export activities of the Company and the new Irish exports venture are not as stark as suggested by HMRC. While the main business did involve some packing of mixed orders, both David and Robert Sandell were clear (and we accept) that the Company did not hold stock on hand as such; David Sandell's evidence was, "We hold goods in third party warehouses for short periods of time for the purposes of receiving goods from suppliers and then dispatching those goods onto customers. For the forty years that we have been in business, we have always operated our business on a back-to-back basis in that we source goods from suppliers according to customer orders and receive/despatch those goods as quickly as possible to keep our warehousing overheads as low as possible."

(3) The problem facing HMRC, and this is a point we return to in relation to other issues below, is that they have raised various issues in support of the Kittel Assessments but, in effect, on the basis of an invitation to the Tribunal to agree with those issues without, in our determination, advancing sufficient cogent evidence. It is clear (and accepted) that the onus of proof lies on HMRC: per Moses LJ in *Mobilx* (at [81]), "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. No sensible argument was advanced to the contrary." We acknowledge that most of the issues listed by HMRC were matters that raised concerns and suspicions for Mr Mills and his predecessors as case officers, but in defending the assessments HMRC must go

beyond concerns and suspicions, and must advance probative evidence of the issue in question. It is possible to infer relevant facts from circumstantial evidence, but that circumstantial evidence must exist and be presented in a credible and persuasive form.

(4) HMRC assert that for the Company to be able to win around £15 million of new business in the first year was "too good to be true". But HMRC leave it at that, with no evidence put before us of, for example, the experience of other new entrants to this type of business, or traders already established. HMRC assert that it was not feasible that WDL could build up turnover totalling millions of pounds, given its trading base; but they call no evidence in support of that assertion, such as the experience of other wholesalers of soft drinks and confectionery. HMRC assert that the Company's profit margin on the Irish exports was (in their view) suspiciously low; but they base this only on a comparison with the main business of the Company which both parties accept is long established rather than a venture into a new market, and they give no comparisons for margins earned by other UK exporters of soft drinks and confectionery.

(5) We set out our conclusions at [41-43] below, after consideration of all the factors put forward by HMRC.

Trader was warned of risks inherent in soft drinks exports, and informed of VAT losses in its deal chains

25. HMRC submit:

(1) The Company had been repeatedly educated by HMRC as to the MTIC risks involved in trading in soft drinks. On several occasions the Company had been provided with copies of both HMRC Notice 726 "Joint and several liability for unpaid VAT" ("**Notice 726**") and the leaflet "How to Spot Missing Trader Fraud: A quick guide to helping you protect yourself and your business from organised criminals" ("**the Leaflet**"). The Company had been warned of its involvement in potentially suspicious transactions, including the issue of tax loss letters, extended verification of its VAT returns, and being included in the continuous monitoring project.

(2) At a visit in January 2014 (ie around 18 months before the start of the period covered by the Disputed Assessments) David Sandell had been handed a copy of the Leaflet, and the HMCR officer emphasised the importance of knowing the Company's suppliers and customers, in order to protect the Company.

(3) In February 2015 HMRC wrote reminding the Company of the risks of MTIC fraud, and referring the Company to the Leaflet. In the same month the Company was entered into the monitoring project, as it was involved in the wholesaling of soft drinks. At a meeting the same month, at which both David and Robert Sandell were present, the Company was warned that soft drinks were goods known to have been used in MTIC frauds; that particularly susceptible were goods not purchased direct from manufacturers or distributors; and that MTIC fraud typically involved moving the goods into the EU. All three factors were present in the deals covered by the Disputed Assessments. The Company had confirmed that the directors had received and read Notice 726 and the Leaflet.

(4) In March 2015 HMRC informed the Company that its 02/15 return had been selected for extended verification. In the same month at a meeting with the Company, HMRC again stated that soft drinks trading was considered a high risk area for MTIC fraud; also that the Company had bought from traders who were neither large traders nor

manufacturers, which was where deal chains were most at risk. After the meeting HMRC sent a further risk awareness letter.

(5) In April 2015 HMRC sent a tax loss letter informing the Company that VAT losses had been traced to fourteen deals involving the Company and Thirst Resolution Ltd.

(6) In July 2015 HMRC informed the Company that its 06/15 return had been selected for extended verification, and on 20 July 2015 HMRC sent a tax loss letter informing the Company that VAT losses had been traced to five deals involving the Company and Grey Trading Supplies Ltd.

(7) At a visit in June 2016 HMRC (i) reiterated their concern that the Company was dealing in soft drinks used in carousel/grey market frauds, and always made high repayment claims; (ii) stated that the Company would remain in the monitoring programme for the foreseeable future; and (iii) warned that a further tax loss letter was being prepared for sending to the Company.

(8) In October 2016 HMRC sent a tax loss letter informing the Company that VAT losses had been traced to numerous deals involving the Company, and traced to VAT losses totalling over £1.4 million. As subsequently confirmed to the Company, these all related to purchases from WDL.

26. The Company submits:

(1) The Company was eager to avoid any involvement in suspicious transactions and had co-operated with HMRC in good faith, understanding that HMRC would alert the company to any suspicions about its counterparties. HMRC's own file notes show that at the January 2014 visit the HMRC officer "advised [David Sandell] that we would make him aware if we identified any tax losses in the deal chain." Again, HMRC's own file notes show that at the February 2015 visit the HMRC officer stated, "HMRC will look at deal chains of supply and inform business if any tax losses identified. It is up to the business to decide what to do with any information it receives, …"

(2) The risk awareness letter sent in March 2015 stated, "MTIC fraud is a well known and highly profitable criminal activity. This typically has involved "high value, low volume" commodities imported VAT-free from EU member states". The goods being traded by the Company were low value, high volume items (soft drinks and confectionery), and were purchased from a UK trader (WDL) – so there was no reason for the Company to think the letter gave it any relevant information.

(3) After the 23 April 2015 tax loss letter informing the Company that VAT losses had been traced to deals involving the Company and Thirst Resolution Ltd, the Company immediately ceased trading with Thirst Resolution. The Company lost a net £60,000 on its dealings with Thirst Resolution.

(4) HMRC's own file notes of the July 2015 visit record that around one year earlier the Company had made an unprompted warning to HMRC concerning a soft drinks deal about which the Company had become suspicious, and aborted.

(5) Before HMRC's tax loss letter dated 20 July 2015 concerning Grey Trading Ltd, the Company had on 19 December 2014 informed HMRC that it had stopped all trading activity with Grey Trading. HMRC had replied the next day stating that HMRC's request for information "shouldn't raise concerns of [an] investigation or infer anything about the legitimacy of Grey Trading Ltd.".

(6) At the December 2015 visit the HMRC officer stated, "removal [from the continuous monitoring project] is something that will be considered." That indicated to

the Company that there were no problems with its supply chains. Swift was discussed but HMRC mentioned no concerns about Swift. Again, given HMRC's earlier assurances that they would "inform business if any tax losses identified", that indicated to the Company that there were no problems with its sales to Swift. The Company had at the relevant time over one hundred customers, and there was nothing about Swift or PKC that distinguished them from the other customers (who HMRC seemed to be happy with).

(7) After receipt of the October 2016 tax loss letter the Company wrote to HMRC:

> "As you will have seen from our latest VAT submission we have currently ceased trading with Wholesale Distribution [ie WDL] or any other suppliers for that matter of what we would consider to be volume traded FMCG [fast moving consumer goods] products.
>
> This affects us greatly and whilst we do not wish to be trading or involved with Chains that obviously have issues we would like to talk to you about how we either proceed or do not if that is the case. We have been speaking to the Due Diligence Exchange and have verified the chain that we were using as far as Wholesale Distributions supplier's supplier but cannot go any further due to that company not wishing to divulge their supply source to DDE.
>
> I would really like to meet with yourselves to get a feel for your own views on the situation if possible please."

(8) The Company had been assured repeatedly by HMRC that it would be warned if any of its deals traced to a VAT loss. The Company had been trading with WDL since April 2014 and received no alert from HMRC about WDL until October 2016, at which point the Company immediately ceased trading with WDL and informed HMRC of that fact. The Kittel Assessments, all of which relate to purchases from WDL, were issued in December 2017 to February 2018; however, HMRC only issued assessments to WDL itself in January/February 2018; if Ms Wilkinson and her MTIC colleagues did not reach a conclusion until early 2018 on WDL's dealings being connected with fraud then why should the Company be presumed to have reached any earlier conclusion?

(9) Notice 726 does not apply to soft drinks or confectionery. The document handed to the Company would have been the March 2008 version of the Notice, relating to joint and several liability for unpaid VAT. The Notice applies only to "specified goods", which are defined as electronic goods such as phones, computers etc. No legitimate business dealing in soft drinks or confectionery would upon reading Notice 726 assume that its contents had any relevance to its trade, because they do not, and that was exactly the conclusion reached by the Company.

(10) The Leaflet gave a number of situations in which traders might be suspicious, but HMRC could point to few of these that were even applicable to the Company's trades in soft drinks and confectionery. For example, none of WDL, Swift or PKC were newly formed businesses; they all demonstrated a very good knowledge of their market; the Company was not instructed to make third party payments; the goods were not high value, low volume items. Of the few items that were applicable, none gave the Company any cause for concern as the deals were all compatible with normal trading in the markets for soft drinks or confectionery.

(11) Through all the regular and frequent HMRC visits it was never suggested to the Company that confectionery was susceptible to MTIC fraud. Indeed, one of Mr Mills's predecessors stated in an email to the Company that she had no experience of confectionery trades being suspect. Despite that, a large part of the deals covered by the

Disputed Assessments involved confectionery. If MTIC specialists at HMRC did not regard purchases and sales of confectionery as potentially suspect, then how could they allege the Company must or should have been aware of this matter?

27. Tribunal consideration:

(1) We deal first with the materials that were provided to the Company by HMRC: Notice 726, the Leaflet, and the risk awareness letter. It is not in dispute that copies of these were provided to the Company on several occasions. HMRC submit that after consulting those materials a trader would have concluded that the deals covered by the Disputed Assessments were not legitimate, or at least would have taken additional steps to verify the legitimacy of those deals. We agree it is good practice for HMRC to draw to traders' attention the risks of becoming involved in deals connected with fraud; the full title of the Leaflet is "How to Spot Missing Trader Fraud: A quick guide to helping you protect yourself and your business from organised criminals". Where HMRC point to the specific contents of those materials and criticise the behaviour of a trader, they must be able to show that the trader should reasonably have been aware that the materials were relevant to the actual deals being conducted, and so should be taken into account by the trader in deciding whether to undertake those deals.

(2) Notice 726 (in the form extant at the relevant time) opens at paragraph 1.1 with the explanation: "This notice explains how you could be made jointly and severally liable for the unpaid VAT of another VAT-registered business when you buy and/or sell specified goods." As Mr Bedenham pointed out, the Notice relates not to potential *Kittel* assessments but to a different regime of joint and several liability; however, we consider the Notice is aimed at explaining to relevant traders the dangers of MTIC fraud – (at paragraph 2.3) "These rules are designed to tackle VAT fraud. A virulent type of VAT fraud is known as Missing Trader Intra-Community (MTIC) VAT fraud. … This type of fraud relies heavily on the ability of fraudulent businesses to sell goods or services to other businesses that are complicit in the fraud, prepared to turn a blind eye, or not sufficiently circumspect about their trading connections. Such action fuels the growth of the fraud. These rules remove the attraction of financial gain." In terms of who are the relevant traders, we do not agree with HMRC that the Notice should have been taken by any trader presented with the Notice to be applicable to their business situation. On the contrary, paragraphs 1.3 and 1.4 of the Notice are specific as to the extent of the contents of the Notice:

> "**1.3 Who should read this notice?**
>
> If you are a VAT-registered business and buy and/or sell certain specified goods mentioned in paragraph 1.4, you should read this notice carefully.
>
> **1.4 What are the specified goods?**
>
> This measure only applies where there is a supply of goods or services that are subject to widespread VAT fraud - in particular, Missing Trader Intra-Community (MTIC) VAT fraud. Given the way in which this fraud continually mutates, including the types of goods that are used to perpetrate the fraud, the list of specified goods was extended in May 2007.
>
> For supplies made between 10 April 2003 and 30 April 2007, the specified goods were:
>
> - telephones and any other equipment, including parts and accessories, made or adapted for use in connection with telephones or telecommunications;

- computers and any other equipment, including parts, accessories and software, made or adapted for use in connection with computers or computer systems.

For supplies made on or after 1 May 2007, the specified goods are any:

- equipment made or adapted for use as a telephone and any other equipment made or adapted for use in connection with telephones or telecommunication;
- equipment made or adapted for use as a computer and any other equipment made or adapted for use in connection with computers or computer systems (including, in particular, positional determination devices for use with satellite navigation systems - ie, "satnavs");
- other electronic equipment made or adapted for use by individuals for the purposes of leisure, amusement or entertainment and any other equipment made or adapted for use in connection with any such electronic equipment.

This final bullet includes items such as digital cameras, camcorders and other portable electronic devices for playing music and games such as iPods, hand-held or portable DVD players, Playstation Portables (PSP's) etc.

Both versions of the legislation use the term "other equipment" in the description of the goods the measure applies to. Whilst this includes parts, accessories and software, it does not include parts such as screws and wires used in the manufacture of general items when sold separately.

"Parts, accessories and software" was used in the original legislation and refers to items made or adapted for use in connection with telephones, telecommunications, computers or computer systems. From 1 May 2007 "any other equipment made or adapted for use in connection with (the categories of goods)" is the wording used.

This includes parts, accessories and software such as telephone chargers, computer chips, memory cards or games cards."

28. It is clear that none of the goods involved in the deals covered by the Disputed Assessments (which were soft drinks and confectionery) constitute "specified goods" as described in the Notice. A trader who was not in the business of dealing in the specified goods – which includes the Company – was not required to read the Notice, nor to take the actions recommended or required by the remainder of the Notice. We conclude that no inferences can be drawn about the Company's behaviour from the fact that it was given copies of an irrelevant Notice.

29. Turning to the Leaflet, this is *not* confined to specified goods, and the material parts of the Leaflet state:

"How to spot VAT missing trader fraud

It is important that you read this leaflet. If you do not take due care and HMRC can demonstrate that you knew or should have known that your trading was linked to fraudulent tax losses then you will lose your entitlement to claim the input tax linked to those transactions.

Be suspicious if your business or those you are dealing with show any of the following characteristics.

- Newly established or recently incorporated companies with no financial or trading history.

- Contacts have a poor knowledge of the market and products.
- Unsolicited approaches from organisations offering an easy profit on high-value/volume deals or no apparent risk.
- Repeat deals at the same or lower prices and small or consistent profit.
- Instructions to make payments to third parties or offshore.
- Individuals with prior history of wholesale trade in high value, low volume goods such as computer parts and mobile phones.
- Unsecured loan with unrealistic interest rates and/or terms.
- Instructions to pay less than the full price (and often even less than the VAT invoiced) to the supplier.
- Established companies that have recently been bought by new owners who have no previous involvement in your sector.
- New companies managed by individuals with no prior knowledge of the product, who hire specialists from within the sector.
- Entities trading from residential or short-term lease accommodation and serviced offices.

This list is not exhaustive - use your common sense and be suspicious.

…

How you can protect you or your business?

Take care that

- you know your business, suppliers and your customers
- you satisfy yourself that a deal looks and feels genuine, and
- you know the provenance of the goods or services you are being offered.

Check that

- the goods you buy exist and are as described
- the integrity of your customers and suppliers
- the commercial viability of the transaction, and
- that the payment arrangements are realistic.

Even if an individual transaction looks fine, you need to consider the trading pattern for that particular commodity."

30. In his cross-examination of Mr Mills, Mr Bedenham took Mr Mills through the first set of bullet points in the Leaflet and Mr Mills accepted that the only characteristics which could have been applicable to the deals covered by the Disputed Assessments were (i) "Repeat deals at the same or lower prices and small or consistent profit"; and (ii) "Entities trading from residential or short-term lease accommodation and serviced offices". On the first of these, Mr Mills noted the purchases from WDL were repeat deals at small profit; on the second, that WDL traded from a small retail outlet called "The Kabin".

31. On the second set of bullet points in the Leaflet, HMRC did not advance evidence sufficient, in our judgment, to show that the Company had failed to protect its business. The Company produced numerous examples of deals not challenged by HMRC which give the

picture of “the trading pattern for that particular commodity” and also showed to our satisfaction that the deals covered by the Disputed Assessments were of the same pattern.

32. The risk awareness letter alerts traders to the risks inherent in “high value, low volume commodities imported VAT-free from EU member states”. However, that description does not apply to the goods in the deals covered by the Disputed Assessments; these were soft drinks and confectionery which are (in the case of the deals under consideration) low value, high volume items, and they were purchased from a UK trader (WDL). We consider that the risk awareness letters sent to the Company would not have added anything to the Company’s general knowledge of potential risks in trading in soft drinks.

33. The Company received three tax loss letters (ie letters from HMRC informing the Company it had been a party in a chain of transactions that had been traced to a tax loss): one in April 2015 relating to a trader Thirst Resolution Ltd, one in July 2015 relating to a trader Grey Trading Supplies Ltd, and one in October 2016 relating (although this is not stated in the letter) to purchases from WDL. In each case the Company ceased trading with the named trader immediately or shortly after receipt of the relevant letter. When HMRC were informed that the Company was ceasing trading with Grey Trading Supplies following the tax loss letter, HMRC replied that the letter should not raise concerns about the legitimacy of Grey Trading Supplies. From these actions we conclude that the Company was quick to cut trading links with businesses where HMRC had alerted the Company to links to tax losses. That is action after the event; the Company’s actions before the tax loss letters can, we conclude, be explained by the Company’s understanding that HMRC would alert the Company to any identified tax losses in its deal chains. Robert Sandell’s evidence was that this was his firm understanding of the effect of the Company being entered into the continuous monitoring project, entailing rigorous checking of all transactions by HMRC before any VAT repayments would be authorised. That understanding is supported by the visit notes of the HMRC officers quoted at [26(1)] above. The Company’s trading was obvious to HMRC because the Company’s VAT returns were on the continuous monitoring project, and thus being examined almost in real time, and in any event Robert Sandell emailed HMRC (Ms Meek) in May 2016 setting out that the relevant deals were all purchases from WDL and sales to either Swift or PKC, that the Company considered all three parties well-established and reliable, that VAT registration checks were repeatedly carried out (with examples given), and that DDEL (see below) had conducted due diligence investigations on all three. There is no evidence that HMRC were somehow unaware of the exact trading activities of the Company, or that any details were being kept from HMRC.

34. Finally, we note that at no time did HMRC caution the Company concerning trades in confectionery goods. There was no reason for the Company to consider deals in Mars bars, Yorkies, Snickers, KitKats and similar as being particularly susceptible to MTIC fraud.

Uncommercial and suspicious aspects of deals

35. HMRC submit that the following factors were probative of the disputed deals not being legitimate:

(1) Sales were back to back transactions. The Company kept no stock on hand to meet the huge increase in sales; indeed, goods were purchased only when a sale had already been identified.

(2) There was no commercial sense in customers sourcing the goods from the Company, when they could buy them either direct from the manufacturers or from WDL who were just over the border and had adequate inventory (indeed, all the goods were

sourced by the Company from WDL). At a visit in June 2016 Robert Sandell stated that, where it can, the Company will buy direct from manufacturers to get the best price.

(3) It was suspicious that every consignment was transported by the same company: John Crilly Transport ("**Crilly**"). No due diligence was ever conducted on Crilly. Crilly was also the transporter on the Thirst Resolution Ltd deals, which resulted in tax losses and also commercial loss to the Company.

(4) Many of the goods were Sterling price-marked, but this did not appear to affect the attractiveness of the goods to the customers. The position of price-marked Red Bull had been noted and commented upon by the Tribunal in *Cavendish Ships Stores* (cited below). Again, there was no commercial sense to such UK price-marked products being bought in large quantities by non-UK customers.

(5) There was evidence of goods originating in the Republic of Ireland being sold back into the Republic, but no queries were raised.

(6) No evidence had been produced of negotiation of price and other terms, nor of formal written contracts or terms of business; this pointed to the deals being contrived and uncommercial from the outset. This was in contrast to the evidenced introduction of Swift to the Company, where the previous potential supplier (Key Brands Ltd) was seen in the email correspondence (September 2015) to be negotiating a price with Swift.

(7) Large quantities of food and drinks goods were transported without any investigation of adequate insurance being in place. There was no provision made for action in respect of damaged or faulty goods. No inspections of the goods were evidenced, despite the obvious risks of counterfeit goods, or goods with short shelf-lives. Again, this was simply uncommercial and pointed to contrivance. There were over 370 deals without any problems on returns or damaged goods, which was unusual and suspicious.

(8) Some deals were split over several invoices, even though these were paid in one lump sum.

(9) Some invoices were satisfied by third party payments from Anypayer and Trade Commodities.

(10) Geographical location – The Company is based in Stoke on Trent, Staffordshire but it bought the relevant goods from a supplier in Northern Ireland (WDL) and sold them to customers in the Republic of Ireland (Swift and PKC), the customers being located only 35 miles from the supplier. HMRC suggest this was suspiciously convenient for the Company, but also query why the supplier and customer required the Company to act as an intermediary, given their geographical proximity to each other.

(11) The business substance of the supplier (WDL) – the supplier had a single director (Mr Crothers) and did not advertise, had no website, had no storage facilities, and appeared to operate from a small retail outlet called "The Kabin". HMRC suggest that this was not a feasible source of legitimate supply for the goods in the quantities involved. The turnover figures for the supplier showed that the business undertaken with the Company was a huge increase in sales over the normal business conducted by the supplier.

(12) So many of the sales to the customers were in transaction chains eventually traced to fraudulent defaulters, as accepted by the Company. This was beyond coincidence. Examination of the chains revealed circularity and the repeated involvement of the same persons.

(13) The identity of the customer was often visible on documentation supplied by the Company to WDL – as evidenced for example by an email dated 26 April 2016 from Robert Sandell to Mr Crothers at WDL, which disclosed the customer was PKC. A trader would not normally disclose such information, for fear that the supplier would contact the customer direct and cut-out the trader from that or future business.

36. The Company submits:

(1) HMRC do not understand what normal trading in this industry area looks like. All the deals were consistent with legitimate trading. Neither Mr Mills as the case officer who issued the Disputed Assessments nor any of his predecessors had made any attempt to understand the industry sector in which the trades were conducted, but considered HMRC were somehow able to accuse the Company of conducting deals that were identifiably uncommercial and illegitimate. HMRC had not contacted the manufacturers of the relevant goods – large, respectable companies such as Red Bull, Mars and Masterfoods – nor authorised distributors of such goods. Mr Mills seemed to be aware of the existence of large wholesale buying groups such as Landmark and Unitas, but not how they operated in practice or the importance of buying discounts made available to members. Similarly, HMRC seemed to have been unaware of or ignored features of the industry such as overrider payments, retros, etc which were central to decisions on pricing and sourcing of goods. From this position of ignorance, HMRC thought they were in a better position to identify illegitimate deals than a trader who had been in successful operation for decades. While HMRC could not be expected to become industry experts in every field, when they chose to make a serious allegation that specific trades were not legitimate then they must demonstrate sufficient understanding of the industry to be able to support that allegation; they had conspicuously failed to do so in this case.

(2) Allegations that repeated identical order sizes were suspicious merely illustrated HMRC's ignorance of the legitimate business. A full trailer load of Red Bull comprised 3,744 units; that was why there were so many orders for 3,744 units – customers were ordering by reference to trailer-loads of goods. Further, what HMRC were doing here was to take a factor that officers dealing with MTIC deals in relation mobile phones were familiar with as a warning flag, and just unthinkingly and uncritically applying it to a completely different industry.

(3) It was not correct that there were no damaged or otherwise unsatisfactory loads. There was a credit from WDL for damaged goods (Red Bull) on 15 January 2016. Also, in November 2015 there was a shortage on a Red Bull delivery to Swift – one layer short (16 cases) – this was noted on the CMR by Crilly and a credit note issued.

(4) Some of the Company's trades with WDL had not been challenged by HMRC, yet the basis and documentation of those deals was identical or similar to those covered by the Disputed Assessments – for example, an evidenced deal in April 2016 for Red Bull to be sold to a customer based in the UK. HMRC had provided no explanation of how they had distinguished those deals, nor how the Company was apparently expected to have made such a distinction.

(5) The fact that separate orders or loads had been included on single invoices, or vice versa, was not suspicious; the evidence was that it was convenient to link purchase orders and invoices for clarity. HMRC had not even tried to explain why there was any indication of illegitimacy or fraud in this respect.

(6) Pricing was not, as HMRC alleged, "suspiciously consistent". Pricing for Red Bull ranged from £13.75 to £15.80. Even if the pricing had been broadly similar, HMRC had

not explained why this would be indicative of fraud rather than legitimate pricing in an open market.

(7) HMRC had no evidential basis for the allegation that there was no negotiation of prices. Robert Sandell's evidence was that developing the Irish export business involved him in a lot of extra work; prices were negotiated, of course, but only the negotiated price was recorded on the purchase order sent to the supplier or received from the customer, and no other paperwork was necessary.

(8) Buying "price marked" goods for a different geographic market was common, as many customers were unconcerned by this feature – for example, cans of Red Bull that were served in bars were usually dispensed from the can before service.

(9) There were no formal, written inspection reports because that was not the practice in this industry. Again, HMRC had uncritically applied a warning flag from mobile phone MTIC frauds to a completely different industry, and drawn a misleading conclusion. Robert Sandell had explained how the contracted transporter would alert the Company to any problems with loads. This was how the Company had always dealt with its main transporter (Cheadle Warehouse Services) – and HMRC appeared perfectly happy with that arrangement – and it also applied to the transporter in Northern Ireland and the Republic (Crilly).

(10) In relation to third party payments, David Sandell had stated that both PKC and Swift had originally paid direct, but PKC did later change to paying via a couple of third parties: Anypayer and Trade Commodities. PKC had not notified this in advance but Mr Sandell picked it up from the bank statements. He did not think this was odd as some overseas customers (eg in New Zealand and Malta) have for years chosen to pay the Company's Sterling invoices via FX companies; he estimated around a dozen current customers pay this way; most payments reference the order number so that the payment can be linked to the relevant invoice.

(11) Robert Sandell had found WDL professional to deal with, and having a good knowledge of the market in which it operated. WDL had been a member of the Palmer and Harvey buying association, which gave reassurance that it was a serious player in the wholesale market.

(12) None of the challenged deals stood out to the Company as not being legitimate market transactions. Several of the features highlighted by HMRC as being suspicious are, in fact, consistent with dealings in the legitimate market.

37. Tribunal consideration:

(1) First, we repeat our earlier statement (see [24(3)] above) that it is not sufficient for HMRC to assert that a matter is suspicious, and then invite the Tribunal to agree with that assertion without cogent evidence in support of the assertion. We take in turn the matters which HMRC contend are suspicious.

(2) Back to back deals – By this HMRC mean that rather than the Company maintaining a warehouse stock of goods out of which customer orders would be met, the Company bought only to satisfy orders already received. The Company's description of its trading model, which we accept, is as follows: the Company has no warehouse facilities of its own; it instructs its vendors to deliver purchases to Cheadle Warehouse Services, a large logistics and freight forwarding business in Stoke which the Company has used for years; if loads are purchased ex works then they are transported from the vendor to Cheadle Warehouse Services by MJS Transport – another company that the Company has used for years; for many years the business of the Company had been

conducted as buying to order, to meet customer requirements. From the Tribunal panel's experience in trying other MTIC allegation cases, we are aware of the list of indications of suspicious trading (sometimes called the "warning flags") used by HMRC's specialist officers when investigating possible MTIC fraud amongst traders in mobile phones and computer chips (ie the specified goods in Notice 726). What does concern us in this case is that HMRC appear to have applied those warning flags when investigating and evaluating the Company's trades that were traced by HMRC to VAT losses, without any attempt to discern whether the flags were truly relevant to trades of FMCGs (soft drinks and confectionery). That would require, we consider, a critical evaluation by HMRC of the deals in the context of the wholesale grocery market, rather than just a read-across of the warning flags from the mobile phone business to the wholesale grocery market. As the Leaflet emphasises, "you need to consider the trading pattern for that particular commodity". From the evidence presented to us, what HMRC called "back to back" trading and described as suspicious, was nothing of the sort, and was simply the way the wholesale grocery business is routinely conducted.

(3) Why would customers not source from manufacturers or WDL? – HMRC query why the Company's customers would not buy from the product manufacturers on price, or from WDL given that all the Company's export stock was sourced from WDL anyway and WDL was just over the border. HMRC's view that best prices would be available by buying from manufacturers or authorised distributors, is not supported by the evidence. We received the following evidence, which we accept: in the wholesale grocery business there is a number of very large "buying groups" (or "clubs") who buy on best available terms on behalf of their members; for example, Landmark (later called Unitas), Today's Group, Sugro and Confex; the clubs source their product from businesses who have bought in enormous quantities (in order to attract manufacturer discounts (below) or similar), or are offloading overstockings (ie excess stock); there are also participants in the market (eg wholesalers, such as Blakemore & Sons) who buy large quantities of stock regularly in order to attract incentives from manufacturers, such as overrider payments (effectively extra sales commissions), advertising allowances, quantity discounts, special offers on promotional lines, "clearances", and "retros"; these allow those participants to sell on (eg to buying clubs) at below manufacturers' list prices but still on a commercially attractive basis. We were shown numerous examples of documentation supporting the above from the Company's own experience, most of which related to well-known products from major manufacturers (eg KraftHeinz) thus supporting that these practices are mainstream rather than confined to the periphery of the industry. We accept Robert Sandell's evidence that (for the above reasons) it is incorrect and misleading to refer to manufacturers' "set prices"; even the invoiced prices of purchased goods do not necessarily reflect the true cost to the trader because of later accounting for "hidden" discounts such as overrider payments.

(4) Transporter – HMRC point out that all the challenged deals were transported by a single company, Crilly, which was also the transporter on the Thirst Resolution Ltd deals (which were associated with tax losses). We cannot draw any adverse conclusion from the Company's decision to contract with a single transporter in Northern Ireland; the same arrangement was made on the mainland where MJS Transport has been used for many years, and so the Company's practice was consistent rather than exceptional and suspicious.

(5) Price-marked goods – A number of the deals covered by the Disputed Assessments were for goods (particularly Red Bull) which were "price-marked" – ie had a Sterling

price marked on the body of the can. HMRC referred us to the comments of this Tribunal in *Cavendish Ships Stores Limited* [2020] UKFTT 0257 (TC):

> "230. Nor does Ms Crompton's response address the sale of price-marked Red Bull to customers in the Irish Republic. Not only is Red Bull not a speciality "British" product, but the sale of price-marked goods into the Irish Republic would flag the risk that the goods would be sold back into the UK – which is an indication of MTIC fraud identified in PN726.
>
> 231. During the 27 April 2016 visit, Ms Shingleton was also asked about the product labelling, and whether English language ingredients labels on products identified for sale in the UK would satisfy regulatory requirements elsewhere in Europe, where English was not the local language – for example in relation to the risk warnings for possible allergic reactions. Ms Shingleton said did not know.
>
> 232. But the answers of Ms Crompton and Ms Shingleton miss the point. At issue here is whether sending "British" labelled goods to customers located in Eastern Europe made commercial sense. The fact that this does not make sense should have put Cavendish on notice that there was something odd about the deal, which would require further investigation. Something Cavendish failed to do.
>
> 233. In all of these cases, there is something that is commercially "unsatisfactory" about the transactions that would put a genuine commercial trader on notice that they ought to make further enquiries. The fact that Cavendish failed to do so is an indication that Cavendish were (at best) deliberately turning a blind eye to the possibility of these transactions being connected with tax fraud."

We note the conclusions drawn by this Tribunal in that case but the evidence in the present appeal is that sales of price-marked goods to Irish customers were not commercially unsatisfactory, and did make sense. Robert Sandell's evidence, which we accept, is that the Company saw nothing strange in trading in price-marked grocery goods abroad – this was a regular feature of exports to markets such as India, China, Nigeria and Ghana, where it was often regarded as a reassurance of the origin of the goods.

(6) Absence of negotiations – HMRC query the apparent absence of negotiations on price and other commercial terms. We agree with HMRC that the Company had produced no significant documentary evidence of price and terms negotiations with counterparties; however we accept the statements by Robert Sandell that he worked long hours developing the Irish business, including evenings and weekends, and he felt it was insulting to suggest – with no evidence offered by HMRC – that the business somehow just fell into the lap of the Company.

(7) Inadequate insurance – HMRC query, in effect, why there were apparently no agreed provisions for what would happen if things went wrong: damaged goods, counterfeit goods, out-of-date stock, etc. First, we must deal with an evidential point. The Company's documentary evidence in the hearing bundle included a copy of an insurance policy schedule; at the hearing the Company accepted that document did not address the point at issue, and applied to substitute an alternative document on which the Company relied. We gave permission for the admission of that replacement document, on the basis that HMRC would have adequate opportunity to address us in relation to it. Having considered the new document, Ms Vicary for HMRC submitted that as a stand-alone item it carried little value; it appeared to be an endorsement of a policy held by Crilly for general road transport and that policy was not available for examination. We agree with HMRC's submission, but we consider the document does demonstrate (albeit

with little detail) that the matter of carriage insurance was not just ignored by the Company; the cover maintained by the carrier (Crilly) with Allianz had been adjusted by "indemnity extensions" with specific reference (by name) to the Company. We make no other findings as to extent or adequacy of the cover. In relation to matters concerning damaged goods or short loads, we accept the evidence presented by the Company and described at [36(3)] above; again, these issues were not ignored by the Company but were instead dealt with on a case-by-case basis.

(8) Deals split over several invoices – HMRC assert that splitting deals over invoices, or vice versa, is suspicious; also, that the deal quantities over time were suspiciously similar. We were given several examples of how the Company would produce invoices to match the customer purchase orders, all of which tallied properly, and HMRC did not advance any specific evidence why the Company's systems did not produce normal accounting results. The quantities of goods being purchased were repetitive, and may have looked odd amounts, but this was simply a reflection of deals in trailer-loads of goods. For example, a complete road trailer load of Red Bull constituted 3,744 cases; a full trailer of four finger bars of KitKats constituted 5,824 cases; and a full trailer of Snickers bars constituted 7,800 cases; those amounts (which we acknowledge appear odd in isolation) are completely explicable when translated into trailer loads. There is nothing suspicious in this regard.

(9) Third party payments – HMRC challenge the bona fides of the Company receiving payments from third parties rather than the customers who were invoiced. First we note that there is no evidence that the Company was ever asked to pay any person other than the vendor, WDL, for the deals covered by the Disputed Assessments. What HMRC draw attention to is that for some later sales, the Company received monies not from the customer direct but instead from a third party. This is, we consider, another example of a mobile phone trade warning flag being applied without adequate explanation of why it should also apply to wholesale grocery transactions. We accept the evidence of David Sandell (at [36(10)] above) that customers abroad paying Sterling invoices via FX bureaux was something the Company was familiar with for several customers over a period of time, and so this did not raise any suspicions when it occurred on a few of the deals covered by the Disputed Assessments.

(10) Geographical location – HMRC query why, given that WDL was geographically close to the Republic (and Swift and PKC in particular), there was any need for the Company to act as an "intermediary". We consider this point has no substance; there is nothing suspicious in a business having suppliers who are located geographically close to the business's customers, and HMRC have put forward no real evidence to suggest otherwise here. The suggestion that the Company acted only as an intermediary, presumably an insinuation of some artificial co-ordination between three or more persons, has no evidential basis.

(11) WDL was insubstantial – As we stated at [24(4)] above, HMRC have called no evidence in support of this pejorative assertion to show that the Company should, at the time it entered into the challenged transactions with WDL, have been suspicious of WDL's substance. WDL was a UK VAT-registered trader and so HMRC had their own records (and Ms Wilkinson was the case officer), unlike the Irish traders Swift and PKC where HMRC could obtain information only from the Irish tax authority. HMRC did not appear to regard WDL's trading as suspicious – at least, HMRC took no action to intervene until around the same time as they issued the Disputed Assessments to the Company. The Company's evidence was that it started trading with WDL in April 2014; it was aware that several of its own customers were themselves customers of WDL, thus

providing comfort as to the substance of WDL; and there was nothing about WDL's conduct that raised any suspicions at the Company. HMRC have not successfully refuted any of those points.

(12) Prevalence of fraud in deal chains – HMRC point to the fact that a high number of the parties in the deal chains were (as accepted by the Company) fraudulent defaulters. This goes only to the nature of the defaults, there is no admission that the Company knew of these connections.

(13) Transparency of customer to WDL – HMRC query why the Company was willing to disclose to WDL the identities of the Company's customers, and risk being cut of current or future business. It was accepted that the shipping marks used by the accounting system did often disclose the identity of the customer. The Company had used this system for decades without problems; in some markets (eg Canada) the identity of the customer had to be disclosed to the manufacturer vendor before the sale could be approved. Robert Sandell's evidence was that merely knowing the customer name would be unlikely to allow the supplier to cut out the Company from business with that customer, and HMRC put forward no specific evidence of such behaviour in the wholesale grocery industry.

Inadequate due diligence

38. HMRC submit:

(1) The due diligence conducted by the Company on its counterparties was at best inadequate and flawed, and at worst merely window-dressing. Everything was outsourced to The Due Diligence Exchange Ltd ("**DDEL**"), who used a generic pro-forma report for each enquiry which did not reflect the circumstances of the particular trader being examined – for example, the extensive paperwork relating to alcohol traders compiled on irrelevant parties. While inapplicable material was included, obvious gaps in information were not pursued; trade references that were promised but not provided were not queried or followed-up; statements by banks that they did not provide trade references were treated as adequate and positive references. A photograph of an empty warehouse operated by PKC was taken and included in the report, but with no query as to why a legitimate trader with a warehouse would not have some stock on hand. The repeated occurrence of the same names and persons (for example, Mr McArdle) was not commented on, and presumably not spotted. Although the reports were stated to be updated (often six-monthly), the same clerical errors (eg a typographical error on a website address) were duplicated on subsequent reports, indicating that the earlier reports were largely just being copied and reissued. Despite all these flaws, the outcome was always an unequivocal conclusion that it was OK for the Company to trade with the person under examination.

(2) The length of the reports contrasts with the lack of reliable information in them. The Company now seemed to seek to criticise DDEL for the flaws in the reports, but it was the Company's responsibility to read the reports and identify any red flags.

(3) Robert Sandell now relies on his trip to Ireland in February 2016 as active due diligence on the Company's supplier and customers, yet this is hardly mentioned in his extensive witness statements. HMRC do not allege that the visit did not take place, but do challenge what useful due diligence purpose was served by the visit.

(4) The Company was aware of the MTIC risks inherent in trades of soft drinks, and received a tax loss letter in respect of deals involving Thirst Resolution Ltd. The

Company held a positive due diligence report on Thirst Resolution and the tax loss letter should have alerted a legitimate business to the fact that its due diligence procedures had failed in respect of that counterparty; instead, the Company just carried on with the same inadequate DDEL reports for other traders. That was because the Company was not truly interested in the content or reliability of the reports, which were merely window dressing.

(5) At a visit in May 2017 HMRC were provided with five due diligence files; when asked about return of these documents David Sandell clarified these were not needed back, saying "they are only of interest to you, we don't use them."

39. The Company submits:

(1) The Company accepts that it was expected to perform due diligence on its suppliers and customers. It took a responsible approach to this task by retaining a professional specialist firm, DDEL, who were recommended by the Landmark buying group to its members. The Company only traded with a business after it had been given a green light by DDEL. The Company is not abdicating its responsibility to perform adequate due diligence, but HMRC seemed to be suggesting that the Company should be overruling or countermanding the advice obtained from an experienced professional firm. If HMRC's references to "window dressing" were an innuendo that there was some form of conspiracy in existence then no evidence had been led in support of a very serious and incorrect allegation. HMRC's criticisms of the reports now are in marked contrast to the enthusiasm expressed by their own officers when shown the reports on their compliance visits to the Company's place of business. HMRC's own file notes show:

(a) After the October 2014 visit the HMRC officer noted, "There was a site visit performed on [another trader] when [named individual] was interviewed by Charlie Cornish from the Due Diligence Exchange Ltd (Assoc. bus. of V. Curley, our well known ex C&E employee)".

(b) At the February 2015 visit, "[Robert and David Sandell] stated that following previous [Specialist Investigations unit] visits, they had used "The Due Diligence Exchange Ltd" as an additional tool, and tried to get a report done every 6 months. [Robert Sandell] produced a comprehensive report they had commissioned for Thirst Resolution Ltd."

(c) After the March 2015 visit the HMRC officer noted, "DD file for Thirst was comprehensive and showed that the Due diligence exchange ltd had conducted a visit on 16/10/14. [Robert Sandell] stated that they had been happy to precede [*sic* proceed] with buying from this trader based on this report and that there had not as far as he was aware been any problems. They were due to have another site visit/report (done every 6 months)."

(2) HMRC's suggestion that the due diligence reports were not read by the Company is plainly incorrect. For example, in November 2014 Robert Sandell alerted Mark Curley at DDEL that a director's passport evidenced in one of the reports was out of date. A copy of the up-to-date passport was subsequently obtained and presented to the Company.

(3) Robert Sandell visited Ireland in January 2016 and met with the directors of Swift, PKC, Crilly and Mr Crothers. Although no written notes had been taken of discussions, Robert Sandell had the opportunity to meet the individuals face-to-face and discuss business matters, thereby getting a good feel for the people involved in the businesses and their industry knowledge.

(4) The Company's witnesses had provided a clear explanation of the comment at the May 2017 visit (see [38(5)] above); these particular due diligence reports related to traders with whom the Company had already ceased to trade, and these reports were therefore no longer used by the Company.

40. Tribunal consideration:

(1) We took a considerable amount of evidence on the matter of the due diligence reports held by the Company on its counterparties; in particular during Ms Vicary's cross-examination of Mr Robert Sandell, and Mr Bedenham's cross-examination of Mr Mills.

(2) Before addressing the specific points highlighted by HMRC as matters which they submit point to the Company not satisfactorily investigating its counterparties, we remind ourselves of the statement by Moses LJ in *Mobilx* (at [82]):

> "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."

(3) More than once HMRC stated that the due diligence reports were mere window dressing and were ignored by the Company. If the suggestion is that the Company did not conduct bona fide due diligence then that is not supported by the fact that the Company retained DDEL to conduct enquiries and produce the reports. DDEL is an independent business offering the service of conducting due diligence enquiries. Robert Sandell's evidence, which we accept, is that the Company used DDEL because DDEL was recommended by Landmark, one of the largest wholesale buying organisations (of which the Company was a member), and DDEL was also the sole approved due diligence service provider for the Today's Group buying group; the Company was using DDEL for a long time before the deals covered by the Disputed Assessments; HMRC officers were complementary about the due diligence carried out by DDEL and not a single officer suggested there were any changes or improvements that needed to be made to this due diligence; when HMRC visit officers had suggested extra checks – eg VIES checks – on counterparties then the Company had always followed that advice.

(4) The Company did look at the reports, contrary to HMRC's submission – Mr Robert Sandell stated that in his evidence and referred to some examples, which we accept. One of those was where he himself spotted that a passport photocopied by DDEL as part of identity checks was out of date, and asked DDEL to recheck that.

(5) We do state that having read through the due diligence reports that were in evidence, we find at least some of them to be less solid than might be hoped for in an independent due diligence report. Much of the work is basic "know your customer" checks on addresses, place of business, companies house registration, VAT registration, identities of directors, bank account details, etc. When the investigation moved to more challenging aspects - such as upstream supplier details, bank and business references, and similar - DDEL appears to have accepted information at face value. For example, there were cases where business references were requested and promised but not provided, yet these were reported as positive responses or marked as information awaited

but with no follow-up. Also, when banks routinely replied that they did not provide customer references in these circumstances, this was reported as a positive bank reference; while it may be confirmation that the trader holds an active bank account at a specific branch, it is not what most businesspeople would consider a "bank reference".

(6) We consider that the Company acted responsibly in contracting with an independent professional firm, recommended by its buying group, for completion of the due diligence reports; it did consider those reports and on at least one occasion queried the contents of a report; the reports were viewed on several occasions by HMRC officers, experienced in MTIC matters, who seemed satisfied with the reports. There was nothing in the reports to suggest to the Company that its dealings would be any different from those conducted in the past, and nothing suspicious was highlighted. We accept the explanation of the Company's witnesses for the comment at the May 2017 visit, which is supported by the chronology of events concerning the traders whose reports were being requested by HMRC.

Conclusions on the Kittel Assessments

41. We find there is no convincing evidence to support HMRC's contention that the Company had actual knowledge that the deals covered by the Kittel Assessments were connected with fraudulent evasion of VAT.

42. On HMRC's alternative contention that the Company should have known that the deals covered by the Kittel Assessments were connected with fraudulent evasion of VAT, we respectfully follow the approach of Proudman J in *GSM Export* – see [9] above – where she made the following points:

(1) The test is simple and should not be over-refined: "should have known" means "knowing or having any means of knowing".

(2) It is *not* sufficient for the taxpayer to know or to have the means of knowing that there was a risk that the transaction might have been connected with fraudulent evasion of VAT, or that it was "more likely that not" that the transaction was so connected. We consider this is the mistaken approach taken by HMRC in deciding to issue the Kittel Assessments; we consider Mr Mills took the view that the circumstances of the relevant transactions revealed suspicious aspects or factors that displayed *a risk* that the transactions might be connected with fraudulent evasion of VAT; that is insufficient. Also, it was a view taken after the event, with the benefit of being able to review in hindsight certain transactions. Mr Mills's predecessors who conducted regular visits to the Company did not seem to hold that view; as late as December 2015 HMRC were considering the removal of the Company from the continuous monitoring project; all the relevant purchases were made from WDL but HMRC saw no need to take any action in relation to WDL until about the same time that they issued the Kittel Assessments to the Company; HMRC reassured the Company that the issue of the tax loss letter relating to Grey Trading Ltd "shouldn't … infer anything about the legitimacy of Grey Trading Ltd"; an HMRC officer told the Company that she was not aware of confectionary goods being susceptible to MTIC trading.

(3) A taxpayer can be regarded as being in a position where he should have known that the transaction was connected with fraudulent evasion of VAT where he should have known that *the only reasonable explanation* for the transaction was that it was connected with fraud. We determine this is not satisfied in this case. The Company's repeated and firm insistence is that the relevant transactions were, contrary to HMRC's submissions, broadly similar to the way the Company had traded for decades, and that was supported by convincing documented evidence. HMRC have not demonstrated that the transactions

were not typical of deals in the wholesale grocery business, let alone that the only reasonable explanation for the transactions was that they were connected with fraud. Goods were sourced to satisfy known customer orders (what HMRC referred to as back-to-back deals) and this was common practice not just to the Company but also for the wholesale grocery business generally. Better prices could often be obtained by buying from persons other than the manufacturers or authorised distributors – in particular, the large buying groups prevalent in the wholesale grocery business. The Company was willing to operate on a low margin because it was attempting to break into a new and possibly lucrative market in the Republic of Ireland. The Company commissioned independent due diligence reports on its counterparties (not just those involved in the deals relevant to the Kittel Assessments), all of which gave a "green light" to trading with those persons. HMRC had repeatedly confirmed to the Company that they would "inform [the Company] if any tax losses identified", and whenever this occurred the Company immediately ceased trading with the named business – even though, as noted above, HMRC assured the Company such notifications should not infer anything about the legitimacy of the business. The Company never traded in the types of goods covered by Notice 726 (broadly, phones and computer equipment); nor in the goods described in the risk awareness letters ("high value, low volume commodities imported VAT-free from EU member states"); and HMRC now accept (or if not, we are satisfied) that most of the flags described in the Leaflet were not present or evident in relation to the relevant transactions. As noted above, an HMRC officer told the Company that she was not aware of confectionary goods (which comprise a significant part of the deals included in the Kittel Assessments) being susceptible to MTIC trading.

43. For the reasons in [42] above, we determine that it is *not* the case that the Company should have known that the deals covered by the Kittel Assessments were connected with fraudulent evasion of VAT. From that conclusion and that at [41] above, we determine the Kittel Principle is not satisfied in relation to the Kittel Assessments. Accordingly, the Company's appeal against the Kittel Assessments is successful in full.

THE MECSEK ASSESSMENTS

44. As stated at [19] above, the question for the Tribunal to determine in relation to the Mecsek Assessments is, did the Company know or should it have known that the deals were part of a tax fraud, and that it had not taken every reasonable step within its power to prevent its own participation in that fraud? HMRC contend the fraudulent persons in question were Swift and PKC.

45. Both Swift and PKC were based in the Republic of Ireland. HMRC made exchange of information requests (pursuant to the mutual assistance regulations) to the Irish tax authority (**the Revenue Commissioners**) and received replies on both companies, which we discuss below. HMRC rely on the contents of those replies as evidence that Swift and PKC were fraudulent.

46. Mr Bedenham for the Company submitted that the Tribunal should be wary of making a finding of fraud against a person who had neither (i) been notified that such an allegation was to be made against them, nor (ii) been given an adequate opportunity to provide their own explanation of events. We were referred to the caselaw in *MRH Solicitors v Manchester County Court* [2015] EWCH 1795, and *Mullarkey & Others v Broad* [2007] EWHC 3400 (Ch) where the learned judge cited (at [41-43]) *Belmont Finance Corporation Ltd v Williams Furniture Ltd, Armitage v Nurse*, and *Paragon Finance plc v DB Thakerar & Co*. We consider that the

approach to be taken, with particular reference to tax appeals, is as stated by the Upper Tribunal in *HMRC v Muhammed Hafeez Katib* [2019] UKUT 0189 (TCC):

> "34. … This forms the basis of the third aspect of HMRC's arguments under Ground 2, namely that before making findings of fraud against Mr Bridger the FTT should have given him an opportunity to explain himself.
>
> 35. In support of that proposition, Mr Watkinson referred us … first to *Vogon International Ltd v Serious Fraud Office* [2004] EWCA Civ 104. In that case the Court of Appeal held that a judge was not entitled to make findings of fraud against a witness appearing for the defendant in proceedings when fraud had neither been pleaded nor put to the witness in cross-examination. That is clearly some distance from the circumstances of this appeal (as Mr Bridger did not appear as a witness for either party and, as we have noted, an allegation of fraud against Mr Bridger had been clearly made). Mr Watkinson was correct to accept that, on its own, this decision does not stand as authority for the third aspect of HMRC's argument.
>
> 36. HMRC submit, however, that the case of *MRH Solicitors v Manchester County Court* [2015] EWHC 1795 extends the principle set out in *Vogon Internationa*l. That case related to county court proceedings involving motor accidents in which the defendant insurance companies denied liability for a claim on the basis that the accidents had been fraudulently staged by drivers of some of the vehicles involved in them. The defendants had not pleaded that the claimant's solicitors were involved in the fraud and indeed they expressly disavowed any such allegation. Moreover, the solicitors were not party to the litigation. Nevertheless, the county court found that the claimant's solicitors were involved in the fraud. The High Court (Burnett LJ and Nicol J) granted the solicitors' application for judicial review of the county court's decision.
>
> 37. HMRC argue that the decision of the High Court in *MRH Solicitors* demonstrates that the FTT was not entitled to make findings of fraud against Mr Bridger because he had not been given a chance to explain himself in the FTT proceedings. They rely, in particular, on paragraphs [34] to [37] of the judgment. We do not, however, consider that the decision is authority for such a broad proposition.
>
> 38. Nicol J gave a single judgment on behalf of both members of the panel. At [34] of that judgment he said that:
>
>> … [I]n the absence of good reason a Judge ought to be extremely cautious before making conclusive findings of fraud unless the person concerned has at least had the opportunity to rebut the allegations.
>
> He went on to explain, at [34] and [35], that such a course was a matter of fairness and, moreover, could avoid the possibility of a court falling into error. At [36], he explained that considerations of common fairness were all the stronger given that fraud against the solicitors had not been pleaded.
>
> 39. In our view, however, the High Court in *MRH Solicitors* was not setting out a general rule that findings of fraud could never be made against non-parties to the litigation without a court first hearing from those parties. Rather, the High Court was simply emphasising the considerations that a court should have in mind before making findings against such persons and the importance of considerations of natural justice. Paragraph [24] of the judgment emphasises that the correct course of action where fraud is alleged against a non-party will depend on the facts of the individual case:

> 24.In the unlikely event that something similar to this should happen in the future, in our view the right course would be for the third party who believes they have been unfairly criticised in a judgment to apply to be joined as a party. We emphasise that we are not saying that a third party who is criticised will necessarily be entitled to be joined as a party. There are many cases heard in the civil courts (and also family and criminal courts) where the conduct of an absent person falls to be considered. For example, in a conspiracy case not all the alleged conspirators may be before the court as parties or witnesses. In complex commercial frauds it may well be part of the case that an absent person or institution was party to dishonest conduct somewhere in the chain. Everything will depend on the facts of the individual case.

> 40. In the circumstances of this case, we consider that the FTT was fully entitled to make findings of fraud against Mr Bridger. Mr Katib had put Mr Bridger's conduct squarely in issue in his witness statement and, as we have concluded above, HMRC had adequate notice of the allegations that were made against him and the relevance of those allegations to Mr Katib's appeal. The facts, therefore, are in marked contrast to those in *MRH Solicitors*, where no fraud against the solicitors had been pleaded. If Mr Bridger or Sovereign Associates were dissatisfied with the findings that the FTT made, in principle they had a remedy since the decision of the FTT would be susceptible to judicial review just as the decision of the county court was in *MRH Solicitors*. However, the mere fact that Mr Bridger or Sovereign Associates might feel aggrieved at findings that were made in their absence does not allow HMRC to escape the implications of those findings."

47. The current case involves an allegation of MTIC VAT fraud which, by its designed nature, brings together a number of persons into a chain to trade the deals. We consider it is not usually practicable for Tribunal proceedings involving an appeal against disputed *Kittel* or *Mecsek* VAT assessments to require or permit participation by persons in the chain who are not the direct parties to the proceedings; as Nicol J stated in *MRH Solicitors* (above), "There are many cases heard in the civil courts (and also family and criminal courts) where the conduct of an absent person falls to be considered. For example, in a conspiracy case not all the alleged conspirators may be before the court as parties or witnesses. In complex commercial frauds it may well be part of the case that an absent person or institution was party to dishonest conduct somewhere in the chain. Everything will depend on the facts of the individual case." The task of the Tribunal in this regard is to evaluate the evidence before us to determine, on the balance of probabilities, whether such a person was dishonest, as alleged. It is up to the party making the allegation (here, HMRC) to decide what evidence they wish to lead in support of their allegation. As the Upper Tribunal stated in *Katib* (above), the mere fact that a third party might feel aggrieved at findings that were made in their absence does not allow the parties to the proceedings to escape the implications of those findings.

PKC

48. On PKC the HMRC request was made on 28 April 2017 and the Revenue Commissioners replied on 5 September 2017. HMRC requested information relating to the period 11/15 to 03/16. The request form contains standard information for confirmation – one of these confirms that PKC ceased activity on 21 August 2017 and its VAT number was cancelled on that same date; another confirms that transport of the relevant goods was by Crilly and the CMRs were being validated. Moving to the bespoke questions, HMRC asked, "Attached is the deal sheet of tax losses incurred by Lynton Exports (Alsager) Limited. These all originate with

Wholesale Distribution and have then been sold on to your trader [ie PKC]. HMRC solely need the next stage for tracking where the goods then went." The Revenue Commissioners replied:

> "C6 Total of purchases from Lynton Exports Ltd ("LEL") per invoices received for the period is €13,273,500.18
>
> C8/C13/C14/C15/C16/C17
>
> PKC process of dealing with LEL is as follows.
>
> Step1 PKC receive a PO by either phone call or email to the directors from its customers
>
> Step 2 PKC forward PO to its supplier Lynton for the goods required.
>
> Step 3 PKC then invoice their own customer.
>
> Step 4 Transportation. At no time does PKC suffer costs of transportation. Goods are delivered to it warehouse in Dundalk, organised by its suppliers and goods are picked up by it customers. In the case of goods purchased from LEL transportation of goods is organised by Lynton. Copies of CMRS have been provided by PKC. Goods are transported by John Crilly's Transport Ltd ("JCT") from Warren Point to Dundalk. I have forwarded a Mutual Assistance ("MA") to the UK regarding JCT requesting validation of some of the CMRS.
>
> Step 5 PKC sales. PKC customers are in Other member States ("OMS") and sales are subject to zero VAT. PKC claim their customer collect the goods at their warehouse in Dundalk. PKC hold no evidence the goods have been dispatched or transported from the state. (MA were issued on a number of its customers requesting such evidence of transportation and same could not be provided.) Additionally a number of PKC's customers are making payments for the goods through 3rd party payers. For example goods are paid for by financial service groups in Hong Kong, Montenegro etc.
>
> Step 6. Onward sale. Goods that were purchased from LEL were sold on by PKC Ltd to its following customers … [list of customers]
>
> I have requested Bank statements from the company in relation to its transactions with LEL. Agent had stated company had mislaid same and had requested duplicates from the bank. To date I have not received any statements or any further correspondence (PCK business bank account is held in Santander located outside of Ireland and an Exchange of Information has issued to the UK).
>
> I am unable to make contact with the directors or book-keeper.
>
> As mentioned above I have issued MA requests to OMS in relation to PKC customers. See summary of MA on these companies that goods from LEL were sold Onward to.
>
> 1) Jays Food Ltd have not at any time purchased goods from an Irish Company they only deal with biscuits, cakes and savouries and do not sell soft drinks It was confirmed by the HRMC that the company has previously had their VAT number hi-jacked.
>
> 2) Falun has a seat only address for the company and the business activity is located in a virtual office there is no possibility of a trade been carried out as a result of our enquiries their VAT no has been ceased.
>
> 3) SlA Market Solutions. The Latvian authorities confirmed that the company have not made any returns and has not responded to any enquiries. And subsequently the authorities have also de registered their VAT nuntier-

I have raised VAT assessment on PKC on sales to OMS of €4,598.225 covering a period from 2013-2016 inclusive. on the basis that Intra community supplies of goods are subject to zero VAT by virtue of Schedule 2 Part 1 Section 1 - (1) VAT CA 2010 on the basis that the goods are dispatched or transported from the state to a person registered for VAT in the Other Member State. It was not possible to confirm the dispatch or transport from the State of the goods zero rated for VAT purposes either from PKC records or by the tax authority in the other member state to where the goods were supposed to be dispatched to.

Also information supplied by OMS within the EU indicated that PKC had imported agricultural machinery in late 2016 & 20l7 This activity is inconsistent with the activities of the company and the company is legally required by virtue of Reg 19(21) to furnish particular of changes of trade within 30 days of the change. Nil Vat returns have been filed for the periods of these purchases and no Vat accounted for.

Therefore I have cancelled the VAT registered number of PKC Wholesale Ltd as of the 21/07/17.

No contact has been made on foot of my assessments or cancellation of the VAT number.

I have also received a letter from the company agent stating in light of their inability to make contact with the directors they feel they have no option but to resign as agents with immediate effect

For your information I have compiled a spreadsheet of transactions between LEL, PKC and the onwards supply of goods. Also forwarded are hard copies of the documents received.

Please note sheet 1 of the spreadsheet identifies the purchases per the download of data from the company and the documents received. Sheet 2 identifies purchases to which I did not received documents for.

I would welcome feedback on your conclusion with Lynton Exports."

49. Our evaluation of this evidence is as follows. The Revenue Commissioners cancelled PKC's VAT number in August 2017. The Revenue Commissioners issued a VAT assessment of around €4.6 million. PKC held no evidence that goods had been despatched or transported from the Republic – ie that the goods had been exported – and no supporting evidence was obtained from the fiscal authorities in the customer locations. Of PKC's (purported) customers, the outcome of the Revenue Commissioners' enquiries was: one was the victim of a VAT registration hijack; one never traded; one never filed any VAT returns and did not respond to enquiries. PKC failed to produce requested bank statements or obtain copies thereof; as the bank was located outside the Republic the reasonable inference is that the Revenue Commissioners were reliant on PKC to demonstrate its banking transactions. The Revenue Commissioners were unable to make contact with the directors of PKC; nor its bookkeeper; and the company's agents had the same experience and resigned from acting. No contact was made by PKC to challenge the cancellation of its VAT registration, or the VAT assessment.

50. From the above evidence we are satisfied on the balance of probabilities that PKC was a VAT fraudster. Although, as Mr Bedenham submitted, the fact of a VAT registration being cancelled does not of itself prove fraud by the trader, the background and reasons why the Revenue Commissioners took that action (set out at [49] above) do so prove to our satisfaction.

51. We then need to determine (i) whether the Company knew, or should have known, that its deals with PKC were part of a tax fraud, and (ii) whether it had taken every reasonable step within its power to prevent its own participation in that fraud. We consider that the first

question is, at least for the purposes of the current appeal, the same question as posed by the *Kittel* test, which we examined and determined at [41-43] above. Our determination there was that we are satisfied the Company did not have actual knowledge of the fraudulent nature of PKC's dealings, and that there was a reasonable explanation for those deals other than that they were connected with fraud. On the second question, we highlight without detailed repetition the points made at [42] above: the commissioning of independent due diligence reports on its counterparties which gave a "green light" to trading with those persons; the Company's co-operation with HMRC throughout the continuous monitoring programme, understanding that it would be informed of any tax losses identified by HMRC; none of the traded goods being of the types within Notice 726 or the risk awareness letters, the flags in the Leaflet being mostly not present or evident, and the Company being told that confectionary goods were not susceptible to MTIC trading. We conclude that the Company did take every reasonable step within its power to prevent its own participation in the tax fraud of which its deals with PKC were a part.

52. For the above reasons, we conclude that the Mecsek Assessments should be reduced to remove all the sales to PKC.

Swift

53. On Swift the HMRC request was also made on 28 April 2017 and the Revenue Commissioners replied on 16 May 2017.[1] HMRC requested information relating to the period 11/15 to 03/06. The request form contains standard information for confirmation – one of these confirms that Swift had not ceased activity as at the date of reply. Moving to the bespoke questions, HMRC asked, "Attached is the deal sheet of tax losses incurred by Lynton Exports (Alsager) Limited. These all originate with Wholesale Distribution and have then been sold on to your trader [ie Swift]. HMRC solely need the next stage for tracking where the goods then went." The Revenue Commissioners replied:

> "This response is based on the information obtained from Swift Valley Trading Limited ("SVTL") over the last 11 months since June 2016. I have not contacted SVTL to request any information as I am of the opinion that I have enough information on hand to deal with this request. However, should you require any further information not included in this response, please let me know.
>
> During October 2016, I visited SVTL and obtained a Data download from their accounting system QuickBooks PRO 2011 multi-user software. From this data, I have extracted the following information in response to your queries
>
> 1. The supplier ledger of Lynton Exports (Alsager) Limited (see File 1). Please note that SVTL software uses exchange rate from Sterling to Euro of 1.32. The data was received in Euro currency and I have included a column using the exchange rate of 1.32 to convert to Sterling.
>
> 2. Based on all information received from SVTL to date, when the question of who did they sell the stock on to is put to them, the reply has consistently been "We cannot provide details of our customers whom this stock went to as we receive the same stock items from a number of suppliers into our warehouse on a weekly basis so therefore it is impossible for us to identify which suppliers stock goes where". (Refer to SCAC's re

[1] There is a typographical error in box C6 of the request form that was noted during the hearing, but which we are satisfied did not misinform or mislead the Revenue Commissioners when making their reply.

> Allied Ship Stores Limited, Alpha Export UK Limited and Cavendish Ship Stores Limited where this response has been consistent).
>
> However, I have analysed all the sales of SVTL during the period from 1st September 2015 to 31st August 2016 of Red Bull, Mars, Snickers and Kitkat (see File 2) using the data extracted from SVTL in October 2016. This spreadsheet shows all sales by SVTL of Red Bull, Mars, Snickers and Kitkat in that period and it details to customers to whom the sales were made to. You will note from the spreadsheet Column N in each tab that most sales of these goods were to traders throughout the EU who have had their vat numbers deregistered and regarding the sales to Sarl Megaplast France, the response I received from France following a SCAC to France in respect of that customer was that "it was replied that the French company has never had any commercial relations with the Irish company Swift Valley Trading Ltd".
>
> C13, C14, C15
>
> I have not obtained this information regarding the transportation of the goods (name and address of transporter, who ordered and paid for transportation, who is owner of means of transportation) from Lynton Exports (Alsager) Ltd to SVTL.
>
> Finally, I note from the spreadsheet that you provided that Wholesale Dist Ltd 830 4647 39 were the supplier of the goods to Lynton Exports (Alsager) Limited; I would be interested to know who supplied these same goods to Wholesale Dist Ltd."

54. Our evaluation of this evidence is that, while the Revenue Commissioners had uncovered certain suspicious aspects to Swift's trading – for example a French purported customer had never had any commercial relations with Swift - the Revenue Commissioners had not taken any action which could be interpreted as a conclusion that Swift was a fraudulent trader. In particular (and in sharp contrast to the position with PKC, above) Swift was still trading as a VAT registered business at the date of the reply to HMRC (May 2017). Moreover, it has become apparent that Swift was still trading as a VAT registered business at the time of the hearing. That last point weighs heavily in our evaluation; the only evidence HMRC have submitted in support of their allegation that Swift was a fraudulent trader in the deals covered by the Mecsek Assessments is the May 2017 reply from the Revenue Commissioners. The facts are that (i) the Revenue Commissioners were content in May 2017 to allow Swift to continue to trade as a VAT registered business, and (ii) the Revenue Commissioners apparently still held that view even as at the date of the hearing. From the above evidence we are satisfied on the balance of probabilities that HMRC have *not* discharged their burden of proof that Swift was a VAT fraudster.

55. For the above reasons, we conclude that the Mecsek Assessments should be reduced to remove all the sales to Swift.

Conclusion on Mecsek Assessments

56. The Mecsek Assessments relate entirely to sales to Swift and PKC. From our conclusions in [52] and [55] above, none of those sales justify denial of zero-rating under the Mecsek Principle and the Company's appeal against the Mecsek Assessments is successful in full.

CONCLUSIONS

57. As stated at [43] above, the Company's appeal against the Kittel Assessments is successful in full. As stated at [56] above, the Company's appeal against the Mecsek

Assessments is successful in full. Together, that disposes of the appeals against the Disputed Assessments in the Company's favour.

DECISION

58. The Company's appeal is ALLOWED in full.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

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

JUDGE PETER KEMPSTER
TRIBUNAL JUDGE

Release date: 20 July 2022

Appendix One

Extract from *Red 12 Trading Ltd v RCC* [2010] STC 589

"[1] This is an appeal from a decision of the Value Added Tax and Duties Tribunal, sitting in London, released on 16 December 2008 ((2008) VAT Decision 20900). By that decision the tribunal dismissed, save in one respect, the appeal under s 83(c) and/or (e) of the Value Added Tax Act 1994 of the appellant, Red 12 Trading Ltd ('Red 12'), against the denial by the respondents, the Commissioners for Her Majesty's Revenue and Customs ('HMRC') of Red 12's ability to deduct input tax in respect of 46 transactions in the tax periods 02/06 and 03/06. The input tax in issue was £2,672,748.

[2] This case concerns what is called 'missing trader intra-Community fraud' ('MTIC fraud'). Anyone reading this judgment is likely to be familiar with this expression, which has been explained in several tribunal and High Court decisions. The classic way in which the fraud works is as follows. Trader A imports goods, commonly computer chips and mobile telephones, into the United Kingdom from the European Union ('EU'). Such an importation does not require the importer to pay any VAT on the goods. A then sells the goods to B, charging VAT on the transaction. B pays the VAT to A, for which A is bound to account to HMRC. There are then a series of sales from B to C to D to E (or more). These sales are accounted for in the ordinary way. Thus C will pay B an amount which includes VAT. B will account to HMRC for the VAT it has received from C, but will claim to deduct (as an input tax) the output tax that A has charged to B. The same will happen, mutatis mutandis, as between C and D. The company at the end of the chain—E—will then export the goods to a purchaser in the EU. Exports are zero-rated for tax purposes, so trader E will receive no VAT. He will have paid input tax but because the goods have been exported he is entitled to claim it back from HMRC. The chains in question may be quite long. The deals giving rise to them may be effected within a single day. Often none of the traders themselves take delivery of the goods which are held by freight forwarders.

[3] The way that the fraud works is that A, the importer, goes missing. It does not account to HMRC for the tax paid to it by B. When HMRC tries to obtain the tax from A it can neither find A nor any of A's documents. In an alternative version of the fraud (which can take several forms) the fraudster uses the VAT registration details of a genuine and innocent trader, who never sees the tax on the sale to B, with which the fraudster makes off. The effect of A not accounting for the tax to HMRC means that HMRC does not receive the tax that it should. The effect of the exportation at the end of the chain is that HMRC pays out a sum, which represents the total sum of the VAT payable down the chain, without having received the major part of the overall VAT due, namely the amount due on the first intra-United Kingdom transaction between A and B. This amount is a profit to the fraudsters and a loss to the Revenue.

[4] The tribunal held that all of the 46 deals save one were part of an MTIC fraud. One deal—deal 32—was tainted by fraud. In respect of 45 of the deals the subject of the fraud the tribunal dismissed Red 12's appeal. In respect of deal 32 the tribunal allowed the appeal because the case was pleaded on the basis of the fraud being an MTIC fraud, adding that, given its finding that deal 32 was tainted by fraud, albeit not MTIC fraud, whether the Commissioners chose to repay the input tax was a matter for them.

[5] A jargon has developed to describe the participants in the fraud. The importer is known as 'the defaulter'. The intermediate traders between the defaulter and the exporter are known as

'buffers' because they serve to hide the link between the importer and the exporter, and are often numbered 'buffer 1, buffer 2' etc. The company which export the goods is known as the 'broker'.

[6] The manner in which the proceeds of the fraud are shared (if they are) is known only by those who are parties to it. It may be that A takes all the profit or shares it with one or more of those in the chain, typically the broker. Alternatively the others in the chain may only earn a modest profit from a mark up on the intervening transactions. The fact that there are a series of sales in a chain does not necessarily mean that everyone in the chain is party to the fraud. Some of the members of the chain may be innocent traders.

[7] There are variants of the plain vanilla version of the fraud. In one version ('carousel fraud') the goods that have been exported by the broker are subsequently re-imported, either by the original importer, or a different one, and continue down the same or another chain. Another variant is called 'contra-trading', the details of which are explained in paras [9] and [10] of the judgment of Burton J in *R (on the application of Just Fabulous (UK) Ltd) v Revenue and Customs Comrs* [2007] EWHC 521 (Admin), [2008] STC 2123. Goods are sold in a chain ('the dirty chain') through one or more buffer companies to (in the end) the broker ('broker 1') which exports them, thus generating a claim for repayment. Broker 1 then acquires (actually or purportedly) goods, not necessarily of the same type, but of equivalent value from an EU trader and sells them, usually through one or more buffer companies, to broker 2 in the United Kingdom for a mark up. The effect is that broker 1 has no claim for repayment of input VAT on the sale to it under the dirty chain, because any such claim is matched by the VAT accountable to HMRC in respect of the sale to United Kingdom broker 2. On the contrary a small sum may be due to HMRC from broker 1. The suspicions of HMRC are, by this means, hopefully not aroused. Broker 2 then exports the goods and claims back the total VAT. The overall effect is the same as in the classic version of the fraud; but the exercise has the effect that the party claiming the repayment is not broker 1 but broker 2, who is, apparently, part of a chain without a missing trader ('the clean chain'). Broker 2 is party to the fraud.

[8] HMRC will have records of whatever returns have been made to them by companies registered for VAT and will know what has been accounted to them and what has not. Using those records and information provided by VAT registered companies they are able to trace a chain of transactions in respect of which output tax received has been accounted for and claims to deduct input tax have been made. They can, thus, trace back from exporter E to (say) importer A. But at some stage the trail is likely to go cold. In the classic version of the fraud it will do so when HMRC gets to A because A and its documents have disappeared. HMRC will know that A has defaulted on its obligations in respect of VAT since it will not have received any of the output tax paid by B to A (as accounted for by B).

[9] However, HMRC may not be in a position to know whether A is in fact the importer or whether there may have been earlier companies in the chain, either as purchasers or transferees, such that its full length was (say) Y – Z – A – B etc. In that example there will have been a defaulter (A), who will not have accounted to HMRC for VAT, but there will also have been an importer (Y). Whether or not Y or Z are liable to account for VAT may depend on the exact nature of the dealings between Y, Z and A, between whom money may not have changed hands.

[10] In a chain of transactions between traders all of whom are honest each trader will account to HMRC for the output tax received (in respect of which the trader acts, broadly

speaking, as agent for HMRC: *Elida Gibbs Ltd v Customs and Excise Comrs* (Case C-317/94) [1996] STC 1387, [1997] QB 499), less any input tax incurred, which he will claim from HMRC. He will, ordinarily, need most of the money received from his sales to pay his supplier and the VAT due. The full extent of any chain will be patent. Where there is dishonesty the position is different. It is in the interests of those who seek to defraud HMRC of VAT to hide the full extent of any chain by the use of buffer companies. Such persons lack any interest in seeing that they, or the companies through whom they operate, are able to account to HMRC for all the VAT that they should."

Appendix Two

The Disputed Assessments, after adjustments discussed at the hearing (Day Four)

VAT Period	Kittel Assessment	Mecsek Assessment	
Nov-15	£119,660.00	£184,107.84	
Dec-15	£121,591.00	£175,999.86	
Jan-16	£211,564.00	£250,445.52	
Feb-16	£307,321.00	£377,252.30	
Mar-16	£363,365.00	£430,149.85	
Apr-16	£647,744.00	£775,496.98	
May-16	£373,403.00	£460,560.68	
Jun-16	£890,388.00	£1,061,408.32	
Jul-16	£366,254.00	£432,895.39	
Aug-16	£530,250.00	£637,563.38	
Sep-16	£458,066.00	£563,228.66	(See Note)
Oct-16	£74,431.00	£87,776.84	
Total	£4,464,037.00	£5,436,885.62	

Note: September 2016 Mecsek assessment is schedule figure of £1,155,014.66 reduced by 6 adjustments of £98,631 (109,590 - 10,959)