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Case Number: TC09418

FIRST-TIER TRIBUNAL
TAX CHAMBER

Taylor House, London

Appeal reference: TC/2022/12562
TC/2022/12565

Keywords – VAT – Kittel – connection – knew or should have known – appeal allowed

Heard on: 9-11 and 13 December 2024
Judgment date: 28 January 2025

Before

TRIBUNAL JUDGE MICHAEL BLACKWELL
MS GILL HUNTER

Between

CHEEMA CONSTRUCTION SERVICES LTD

First Appellant

MR KULMINDER CHEEMA

Second Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr David Bedenham, instructed by KANGS Solicitors.

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

DECISION

INTRODUCTION

1. The First Appellant ("CCSL") was incorporated on 17 April 2009. The nature of business is listed at Companies House as "construction of roads and motorways" and "other specialised construction activities not elsewhere classified." The Second Appellant, Mr Cheema, has been the sole director since incorporation.

2. In broad terms, CCSL makes supplies of construction/concrete formwork. It does not have any employed workers; instead CCSL hires workers from other labour suppliers as needed and, in turn, supplies this labour onto its own customers. Within these appeals it is alleged by HMRC that the supply chains in which CCSL traded can all be traced back to a tax loss and that it, and its director Mr Cheema, knew or should have known this to be the case.

3. The appeals are against the following decisions of HMRC to deny CCSL the right to deduct input tax in respect of VAT periods 01/20 to 07/21; and to impose associated penalties on both CCSL and Mr Cheema. The particulars of the disputed decisions are summarised below:

   (1) Decision dated 14 April 2022 refusing CCSL's claim to deduct input tax claimed on the purchase of labour from Woodside Contracts Limited ("Woodside"). CCSL's right to deduct input tax was denied on the grounds that, having undertaken an extended verification of the relevant transactions, HMRC were satisfied that those transactions resulted from the fraudulent evasion of VAT and that CCSL knew, or should have known, that this was the case, applying the principle (the "*Kittel* Principle") in *Kittel v Belgium* (C-439/04), *Belgium v Recolta Recycling SPRL* (C-440/04) [2008] STC 1537 ("*Kittel*"). This decision was upheld on review, with the conclusions of the reviewing officer being notified to CCSL by letter dated 4 August 2022.

   (2) By decision letter and penalty notice dated 21 April 2022, HMRC assessed CCSL to a penalty in accordance with section 69C of the Value Added Tax Act 1994 ("VATA 1994"). This decision was upheld on review, with the conclusions of the reviewing officer being notified to CCSL by letter dated 15 September 2022.

   (3) By decision letter and penalty notice dated 10 May 2022, HMRC assessed Mr Cheema to a penalty in accordance with section 69D of VATA 1994. No review of this decision was sought.

4. The Appellants' appeals are against the above decisions.

ISSUES TO BE DETERMINED

5. In relation to the denial of input tax, in accordance with the *Kittel* Principle, the Tribunal must be satisfied of the following matters:

   (1) Whether there was a VAT loss?

   (2) If so, whether this loss resulted from a fraudulent evasion?

   (3) If so, whether the transactions that are the subject of this appeal are connected with that evasion?

   (4) If so, whether the Appellant knew or should have known that the transactions were connected to fraud.

6. The Appellants do not dispute (1) and (2). Hence it is (3) and (4) which are in issue.

7. Should the Tribunal dismiss CCSL's appeal in relation to the *Kittel* denial, the penalty on CCSL under section 69C VATA 1994 will follow: subject to any mitigation that the

Tribunal sees fit to apply pursuant to section 70 VATA. The penalty under section 69D VATA 1994 additionally requires the Tribunal to be satisfied that the actions of CCSL were attributable to its sole director, Mr Cheema.

8. The structure of our decision is as follows. We initially consider the legal framework. We then provide findings of fact from the evidence of the three witnesses and the 5,788 pages of the hearing bundle and a supplementary bundle of 34 pages, and then apply the legal framework to those facts.

THE LAW

The right to deduct input tax

9. The right of a taxable person to deduct input tax is contained within sections 24-29 of VATA 1994. In particular:

(1) section 25 of VATA requires a taxable person to account for and pay any VAT on the supplies of goods and services which he makes and entitles him to a credit of so much of his input tax as is allowable under section 26: see section 25(2); and

(2) section 26 of VATA gives effect to Article 168 of EC Council Directive 2006/112 (the "VAT Directive") and allows the taxable person credit in each accounting period for so much of the input tax for that period as is attributable to supplies made by them in the course or furtherance of his business: see section 26(2).

10. The evidential requirements to be satisfied by a trader wishing to exercise his right to deduct input tax are set out within the Value Added Tax Regulations 1995 (SI 1995/2518) (the "VAT Regulations"). In particular:

(1) the obligation of a registered person to provide a VAT invoice is defined in Regulation 13;

(2) the requirements for the contents of a VAT invoice are defined in Regulation 14; and

(3) a trader is required to, *inter alia*, hold or provide the document required in Regulation 13 or such other evidence to support their claim as HMRC may direct, by Regulation 29(2).

11. Those provisions reflect and transpose the corresponding European Community laws contained within Articles 167 and 168 of the VAT Directive.

The loss of the right to deduct input tax

12. The right to deduct input tax will be lost where a taxable person "knew or should have known" that his transaction was connected with the fraudulent evasion of VAT. This is a test that was originally laid down by the Court of Justice of the European Communities ("CJEU") in *Kittel*. There the CJEU stated:

> "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.
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> 57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
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> 58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

> 59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.
>
> …
>
> 61. By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT."

13. The *Kittel* Principle was elaborated on by Moses LJ sitting in the Court of Appeal in *Mobilx Ltd v HMRC* [2010] EWCA Civ 517; [2010] STC 1436 ("*Mobilx*") where he stated:

> "43. A person who has no intention of undertaking an economic activity, but pretends to do so in order to make off with the tax he has received on making a supply, either by disappearing or hijacking a taxable person's VAT identity, does not meet the objective criteria which form the basis of those concepts which limit the scope of VAT and the right to deduct (see *Halifax* at [59] and *Kittel* at [53]). A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and, equally, fails to meet the objective criteria which determine the scope of the right to deduct.
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> …
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> 52. If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in *Kittel*. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

14. In *Mobilx* the Court of Appeal went on to sound a note of caution in relation to attempts to improve upon the principle laid down in *Kittel*:

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

15. In relation to the phrase "the only reasonable explanation" it is important to note, as confirmed by Proudman J. sitting in the Upper Tribunal in the case of *GSM Export (UK) Ltd and another v HMRC* [2014] UKUT 0529 (TCC), that *Mobilx* does not purport to change the test in *Kittel*.

> "19. However, *Mobilx* does not purport to change the test in *Kittel's* case. The requirement as to the taxpayer's state of mind squarely remains 'knew or should have known'. The reference to 'the only reasonable explanation' is merely a way in which HMRC can demonstrate the extent of the taxpayers' knowledge, that is to say, that he knew, or should have known, that the transaction was connected with fraud, as opposed to merely knowingly running some sort of risk that there might be such a connection."

16. The Court of Appeal in *Mobilx* (at [83]) then affirmed guidance on the treatment of circumstantial evidence in cases of VAT fraud. In doing so the Court of Appeal quoted Christopher Clarke J. in *Red 12 Ltd v HMRC* [2009] EWHC 2563; [2010] STC 589 ("*Red 12*"), who had said:

> "109. Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and 'similar fact' evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.
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> 110. To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
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> 111. Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

17. Further, in *AC (Wholesale) Ltd v HMRC* [2017] UKUT 191 (TCC), the Upper Tribunal considered *Mobilx* concluding that the "only reasonable explanation" test is simply one way of showing that a person should have known that transactions were connected to fraud. On this, the Upper Tribunal went on to state that:

> "29. It is, to us, inconceivable that Moses LJ's example of an application of part of that test, the 'no other reasonable explanation', would lead to the test becoming more complicated and more difficult to apply in practice. That, in our view, would be the consequence of applying the interpretation urged upon us by Mr Brown [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.
>
> 30. Of course, we accept (as, we understand, does HMRC) that where the appellant asserts that there is an explanation (or several explanations) for the circumstances of a transaction other than a connection with fraud then it may be necessary for HMRC to show that the only reasonable explanation was fraud. As is clear from *Davis & Dann*, the FTT's task in such a case is to have regard to all the circumstances, both individually and cumulatively, and then decide whether HMRC have proved that the appellant should have known of the connection with fraud. In assessing the overall picture, the FTT may consider whether the only reasonable conclusion was that the purchases were connected with fraud. Whether the circumstances of the transactions can reasonably be regarded as having an explanation other than a connection with fraud or the existence of such a connection is the only reasonable explanation is a question of fact and evaluation that must be decided on the evidence in the particular case. It does not make the elimination of all possible explanations the test which remains, simply, did the person claiming the right to deduct input tax know that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT or should he have known of such a connection."

18. A taxpayer does not need to know specific details of the fraud being perpetuated. In *Fonecomp Ltd v HMRC* [2015] EWCA Civ 39; [2015] STC 2254 the Court of Appeal (Arden LJ) said:

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

19. It is dishonest for a person deliberately to shut their eyes to facts which they would prefer not to know. If he or she does so, they are taken to have actual knowledge of the facts to which they shut their eyes. See, for example, *Beigebell Ltd (No.2) v HMRC* [2023] UKFTT 363 (TC) and *Cavendish Ships Stores v HMRC* [2020] UKFTT 257 (TC). Such knowledge has been described as "Nelsonian" or "blind-eye" knowledge": see judgment of Lord Scott in *Manifest Shipping Company Ltd v Uni-Polaris Shipping Company Ltd and others* [2001] UKHL 1; [2003] 1 AC 469:

> "112. 'Blind-eye' knowledge approximates to knowledge. Nelson at the battle of Copenhagen made a deliberate decision to place the telescope to his blind eye in order to avoid seeing what he knew he would see if he placed it to his good eye. It is, I think, common ground – and if it is not, it should be – that an imputation of blind-eye knowledge requires an amalgam of suspicion that certain facts may exist and a decision to refrain from taking any step to

> confirm their existence. Lord Blackburn in *Jones v Gordon* (1877) 2 App Cas 616, 629 distinguished a person who was 'honestly blundering and careless' from a person who 'refrained from asking questions, not because he was an honest blunderer or a stupid man, but because he thought in his own secret mind – I suspect there is something wrong, and if I ask questions and make farther inquiry, it will no longer be my suspecting it, but my knowing it, and then I shall not be able to recover'. Lord Blackburn added 'I think that is dishonesty'."

Approach to assessment of circumstantial evidence

20. In *Mobilx* Moses LJ stated:

> "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…
>
> 82. But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. … Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focusing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was."

21. The case law indicates that it is necessary to guard against over-compartmentalisation of relevant factors, and to stand back and consider the totality of the evidence: see *Davis & Dann Ltd v HMRC* [2016] EWCA Civ 142, [2016] STC 1236 ("*Davis & Dann*") and *CCA Distribution Ltd v HMRC* [2017] EWCA Civ 1899; [2018] STC 206 ("*CCA Distribution*").

22. In considering circumstantial evidence, the Tribunal should take care not to restrict itself to considering each piece of evidence alone and in isolation from the others. This is because circumstantial evidence is not a chain, where a break in one link breaks the chain, but is a cord: one strand of the cord might be insufficient to sustain the weight, but three strands together might be sufficient: see *R v Exall* (1866) 4 F&F 922, per Pollock CB, cited with approval by the Upper Tribunal *CCA Distribution* at [91]. Accordingly, the whole can end up stronger than the individual parts: see the decision of Judge Christopher McNall in *Wholesale Distribution Ltd v HMRC* [2024] UKFTT 00514 (TC) at [49]

23. Further, it is necessary to consider individual transactions in their context, including drawing inferences from a pattern of transactions, and to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them: see *Red 12* at [109] to [111]. In effect, as a facet of the guidance given in *Red 12*, it is necessary to guard against over-compartmentalisation of relevant factors, and to stand back and consider the totality of the evidence: *Davis & Dann* and *CCA Distribution*.

Burden and standard of proof

24. Where HMRC rely on the *Kittel* Principle, it is for HMRC to prove that each element of the test set down by the CJEU is satisfied (see *Mobilx* at [8]), namely:

(1) there was fraudulent evasion of VAT;

(2) CCSL's purchases on which input tax have been denied were connected with that fraudulent evasion of VAT; and

(3) CCSL knew or should have known that its purchases were connected with fraudulent evasion of VAT.

25. As the CJEU underscored at paragraph [47] of *Kittel*, the right to deduct is "an integral part of the VAT scheme [which] in principle may not be limited". Accordingly, the Tribunal must, before allowing that right to be interfered with, be satisfied that HMRC have proved each element of the *Kittel* test in relation to each purchase that they seek to deny input tax on.

26. It is not enough for HMRC to prove that CCSL's purchases *might* be connected with fraudulent evasion of VAT. Rather, HMRC have to prove, on the balance of probabilities, that CCSL's purchases *are* connected with fraudulent evasion of VAT.

27. Similarly, it is not enough for HMRC to prove that CCSL knew or should have known that its purchases *might* be connected with fraudulent evasion of VAT, were *probably* connected with fraud or were *likely* connected with fraud. Rather, HMRC have to prove, on the balance of probabilities, that CCSL knew or should have known that its purchases *were* connected with fraudulent evasion of VAT.

28. The standard of proof is the civil standard of the balance of probabilities. As confirmed by Lord Hoffman in *Re B* [2008] UKHL; 35 [2009] 1 AC 11:

> "[13] I think the time has come to say, once and for all, that there is only one civil standard of proof, and that is proof that the fact in issue more probably occurred than not.
>
> …
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> [70] …[the civil standard of proof] is the simple balance of probabilities, neither more nor less. Neither the seriousness of the allegation nor the seriousness of the consequences should make any difference to the standard of proof to be applied in determining the facts. The inherent probabilities are simply something to be taken into account, where relevant, in deciding where the truth lies."

THE HEARING

29. We heard live witness evidence in the following order:

(1) Officer Dean James – a member of the Fraud Investigations Service, Cardiff;

(2) Officer Laureen McNally – a member of the Fraud Investigations Service, Belfast;

(3) Mr Cheema.

FINDINGS OF FACT

General finding on witness evidence

30. We consider both Officer James and Officer McNally were honest witnesses who sought to assist the Tribunal.

31. We found Mr Cheema's evidence on certain points to be somewhat evasive. For example, it was noticeable that when he was asked about the identity of workers who completed the various HMRC surveys in 2015 he was unable to recall details. However, when he was asked about the workers whose work was supplied through Woodside he was able to comment with confidence and immediacy.

32. This was a general feature of his evidence, in which he was more forthcoming in relation to the issues under dispute rather than the historic background of his dealings with HMRC.

33. Part of that may be due to the passage of time. We also note that a witness may be truthful on some matters but not on all. On the matters that related to his dealings with Woodside we found Mr Cheema to be more forthcoming.

Connection

34. The Appellant does not dispute that Daniella Enterprises Ltd, Dione Traders Ltd, Sandhar Consultancy Ltd, Build Wise Ltd or Build 247 Ltd (the "Fraudulent Defaulters") have evaded VAT. Rather, the issue between the parties is whether those tax losses can be traced/connected to the transactions between CCSL and Woodside.

HMRC's case

35. HMRC say that it is central to the question of whether the transactions can be said to be connected to the tax losses, that Woodside only had the Fraudulent Defaulters as their labour suppliers. Therefore, all the labour supplied to CCSL by Woodside can be traced to a fraudulent tax loss.

36. There is no reference to any self-employed individuals being paid through the Construction Industry Scheme ("CIS") by Woodside. Rather, Woodside paid the Fraudulent Defaulters who failed to declare any workforce on their monthly CIS returns or filed no CIS returns in all of the periods.

37. Accordingly, there is no merit in an argument to the effect that HMRC cannot prove that it was workers from the Fraudulent Defaulters that actually were on CCSL's sites; the short position is that the only supplies of labour shown to be purchased by CCSL from Woodside are supplies that commence with a Fraudulent Defaulter.

38. The transaction chains during the relevant periods are as set out within the Statement of Case and within the statement of Officer Dean James. In short, each follows the format:

Fraudulent Defaulter → Woodside → CCSL → customer

39. HMRC note that Woodside was originally considered to be a buffer company. However subsequently assessments and an associated penalty were raised against Woodside and its director for periods 07/19 to 04/21 denying input tax in the sum of £1,074,664 on the basis that it had failed to supply invoices to support its claims. It is on this basis that HMRC say, in their skeleton argument, it is now considered a "defaulter". It was also deregistered. Woodside did not challenge or pay the assessments and penalties. However, notwithstanding the foregoing, HMRC's pleaded case proceeds on the premise that the default lies with the Fraudulent Defaulters (and not Woodside).

The Appellants' case

40. The Appellants' case is that Officer Dean James explained how he had sought to "trace" the transaction chain for the Woodside purchases. In short, Officer James looked at Woodside's CIS returns for each of the periods in which Woodside supplied labour to CCSL. Because Woodside's CIS returns in relation to those periods only showed payments to the Fraudulent Defaulters, Officer James concluded that the labour supplied to CCSL must, in each instance, have been sourced by Woodside from one of the Fraudulent Defaulters.

41. However, rather than focusing solely on the CIS records, Officer James should have had regard to Woodside's VAT records. Had he done so, he should have noticed the same thing that Laureen McNally, the allocated officer for Woodside did, namely that Woodside's

VAT returns appeared to show a level of sales beyond those recorded on Woodside's CIS returns leading Officer McNally to state:

> "a VAT vs CIS comparison showed overall over-declarations of output tax in the periods 07/19 to 04/21, however this may or may not have been due to the Construction Industry sales as [Woodside] may have other sales not related to the Construction Industry that it was declaring on its VAT returns"

42. Officer McNally then exhibits a spreadsheet that shows:

(1) in periods 01/20 to 04/21, the output tax declared by Woodside was £1,003,656.85;

(2) based on Woodside's CIS returns, Officer McNally expected Woodside's output tax to be £747,666.80; accordingly

(3) there was some £255,990 of output tax declared by Woodside in periods 01/20 to 04/21 that could not readily be attributed to labour purchases shown on Woodside's CIS returns (ie the labour purchased by Woodside from the Fraudulent Defaulters).

43. CCSL's input tax on purchases from Woodside in periods 01/20 to 04/21 totalled £261,432.65 – sufficiently close to the £255,990 of "extra" output tax declared by Woodside to question whether HMRC has proved that the labour purchased by CCSL from Woodside was sourced by Woodside from the Fraudulent Defaulters.

44. In period 07/21, Woodside did not file a VAT return. CCSL's input tax claim in this period was £53,710. Given in the earlier VAT periods, Woodside appears to have been making supplies that were not connected with the Fraudulent Defaulters, there is also a possibility of the same being the case in the 07/21 period.

45. HMRC could, potentially, have avoided the above difficulties by advancing an argument that Woodside was itself a fraudulent defaulter (in the sense of failing to account for output tax). However, that case was not pleaded by HMRC and, quite properly in view of that, HMRC's counsel made clear that was not a case that was being advanced by HMRC.

Discussion

46. We accept that the Appellants did not fully particularise their case on this point in either their response to the *Fairford* directions, or in their skeleton argument. Nonetheless we do not find that HMRC have been unfairly disadvantaged. The discrepancy with the output tax of Woodside was highlighted by Officer McNally in her witness statement, which should have put HMRC on alert to this issue. Further HMRC accept that the Appellants were not in breach of the *Fairford* directions. HMRC could have made an application to the Tribunal to require the Appellants to more fully particularise their claim in respect of the issue of connection prior to the hearing. They did not do so.

47. It is not disputed that the output tax of Woodside exceeds its declared CIS supplies. As observed by the Tribunal at the hearing, there would appear to be three plausible alternative explanations:

(1) Woodside made supplies of labour from its own employees who were paid through PAYE. Such employees would not appear on the CIS return.

(2) Woodside made supplies of labour sourced from self-employed individuals in addition to that from the Fraudulent Defaulters. Whilst this should have been included on the CIS return, it was not.

(3) Woodside made supplies of goods/services outside the CIS. These were correctly omitted form the CIS return, and included on the VAT return.

48. With regard to (1), Officer McNally testified that at relevant periods Woodside had 3 or 4 employees shown on their PAYE returns and accounts. Given the rates of pay we have seen, these are unlikely to account for the discrepancy. Officer McNally's testimony quoted at [41] above thus suggests that the explanation would either be (2) or (3). Mr Cheema's evidence was that he thought Woodside had 30 employees paid through PAYE.

49. The burden of proof is on HMRC and they have made no enquires with Woodside to verify the nature of the supply. HMRC's argument against (2) relies on Woodside having been compliant with its CIS obligations. The fact that such supplies should (as HMRC observed in their written closing) have been included in the CIS return, but were not, would not be particularly surprising. For the reasons highlighted by HMRC at [39] above, Woodside does not appear to have been an especially compliant company. Accordingly it would not be surprising if they have failed to comply with the CIS.

50. Because of these additional supplies (not from the Fraudulent Defaulters) we find HMRC's reasoning in relation to connection to be flawed – the supplies to CCSL could have been from these additional sources. The striking similarity in value between these additional supplies and the supplies to CCSL (see [43] above) is suggestive that these may have been the supplies made to CCSL.

51. For these reasons, and the additional reasons argued by the Appellants, which we adopt, we consider that HMRC has not shown on the balance of probabilities that the transactions that are the subject of this appeal are connected with the Fraudulent Defaulters. That finding is sufficient to dispose of this appeal in favour of the Appellants.

KNEW OR SHOULD HAVE KNOWN

52. Given our finding on connection it is strictly unnecessary for us to make findings on the issue of knew or should have known. However, as we heard argument on the issue, and in case the case is appealed, we make findings. In making these findings we are mindful of the *Practice Direction from the Senior President of Tribunals: Reasons for decisions* (4 June 2024), that while reasons must be adequate they should also be appropriately concise.

53. We discuss below the alleged sources of knowledge/means of knowledge that CCSL had. We discuss the various sources in turn, but have kept in mind the need to evaluate the evidence in the context of the whole. We then conclude by making a holistic assessment of "knew or should have known", viewing the evidence in the round.

Alleged sources of knowledge/means of knowledge

54. HMRC say that prior to the period under appeal, CCSL and Mr Cheema were well aware of the risks of VAT fraud within the labour supply industry, and of the steps that could be taken to mitigate against this risk, due to (i) receiving letters ("Dereg Veto Letters") informing CCSL that its suppliers had been deregistered for VAT; and (ii) visits by HMRC. From these they say that CCSL and Mr Cheema were aware of the need to carry out due diligence on its suppliers, but did not do so, showing knowledge of VAT fraud. HMRC also say because of Mr Cheema's experience in the construction industry he would, regardless of what HMRC told him, have been alive to the risk of VAT fraud. HMRC in addition point to a number of other behaviours they say are indicators of contrivance.

Dereg Veto letters

55. HMRC observe that Dereg Veto Letters informing CCSL that its suppliers had been deregistered for VAT were sent to CCSL on the following occasions:

Date	Company
19 January 2011	Alpha UK Maintenance Ltd

25 May 2011	Cloth Construction Ltd
23 September 2011	DYH Services Ltd
28 May 2012	Naher 1 Sitebuild Ltd
23 August 2012	SSD Contracts Ltd
18 October 2012	Ondemand UK Solutions Ltd
30 January 2015	Delta Kent Ltd
28 April 2015	Mag 1 Ltd
30 August 2018	Raj Contracts Ltd
1 November 2019	QM Construction Ltd
21 July 2021	Woodside Contracts Ltd
10 May 2022	JJPS Construction Ltd

56. From 28 May 2012, with the exception of the letter sent regarding Ondemand UK Solutions Ltd on 18 October 2012, all Dereg Veto Letters contained the following statement:

> "It is good commercial practice for all businesses to carry out checks to establish the credibility and legitimacy of their supplies, customers and suppliers in order to avoid involvement in supply chains where VAT and/or other taxes will go unpaid. [we/I] would like to draw your attention to the HMRC Notice 'Use of Labour Providers – Advice on due diligence' which includes details of the kind of due diligence checks businesses should be undertaking (and fully recording) to avoid dealing with high-risk businesses and individuals. This can be accessed through the HMRC internet site through http://www.hmrc.gov.uk/use of labour providers

57. Further, from 30 August 2018 the Dereg Veto Letters stated:

> "We've identified increasing problems with fraud and unpaid taxes with businesses in your trade sector. HMRC takes all forms of non-compliance and fraud seriously, regardless of where it occurs or who commits it. It deploys a range of civil and criminal interventions in order to deliver maximum impact and to ensure everyone pays the right amount of tax. We're taking steps to combat these losses by tackling specific schemes to defraud and support legitimate business. Our leaflet 'Use of Labour Providers – Advice on due diligence' gives guidance to businesses which use labour providers. For a copy, go to
>
> www.gov.uk/government/publications/use-of-labour-providers"

58. It was accepted by Mr Cheema that he had received these letters.

59. It was also accepted that the majority of the companies that had been deregistered were labour suppliers to CCSL (the one exception pointed out by Mr Cheema being Raj Contracts Ltd).

60. Officer James conceded that the Dereg Veto Letters sent to CCSL did not mention that the suppliers (all of whom CCSL had ceased any dealings with prior to receiving the Dereg Veto Letters) had been de-registered due to fraud. We consider that to be significant.

61. The only "tax loss" letter (specifying that CCSL was involved in a defaulting chain) sent to CCSL prior to the purchases from Woodside was a letter relating to Raj Contracts (in May 2018) – which it will be recalled was not a labour provider.

62. We also consider it to be significant that, as Officer James also acknowledged, following the Dereg Veto Letters in 2011/12 there was then a gap until 2015 and then a further gap until 2018 and 2019. Indeed, by the time of the relevant VAT period most of these Dereg Veto Letters were somewhat historic. That is not to say that Mr Cheema would have been entitled to forget those letters, but their impact will have diminished over time.

63. All these factors limit the extent to which Mr Cheema will have been alive to the potential of VAT fraud and should have known that the supplies from Woodside were connected to fraudulent transactions. Further, the fact that Mr Cheema will have been aware there was VAT fraud in the industry cannot *of itself* lead to the conclusion that the supplies from Woodside were connected with fraud, since there was also a legitimate market in addition to the fraudulent one.

HMRC leaflets – Use of Labour providers, advice on due diligence

64. Due diligence letters containing HMRC leaflets on due diligence were sent to CCSL on the following occasions:

Date	Information
20 January 2011	Due Diligence letter, enclosing HMRC Notice: *Use of Labour Providers – Guidance to assist your due diligence.*
9 December 2014	Due Diligence letter, enclosing HMRC Notice: *Use of Labour Providers – Advice on due diligence.*
10 October 2018	Due Diligence letter, enclosing HMRC Notice: *Is your labour supplier damaging your business?*

65. Mr Cheema accepted that these letters had been received.

66. The various available iterations of the HMRC leaflet *Use of Labour Providers – Advice on due diligence* were provided to the Tribunal. These alert traders to problems encountered with fraud in the labour supply market. They set out a list of the types of questions and enquiries that HMRC say a trader should be embarking on.

67. Examples of the checks listed include:

(1) obtaining copies of the Certificate of Incorporation, VAT registration certificate and GLA License and confirming the PAYE reference;

(2) verifying VAT registration details with HMRC and making regular checks of all VAT registration numbers afterwards;

(3) insisting on personal contact with the directors of the prospective supplier;

(4) visiting the premises of the suppliers to confirm that those persons actually run their business day to day;

(5) obtaining trade references and letters of introduction on headed paper;

(6) obtaining credit checks from an independent third party;

(7) obtaining the prospective supplier's bank details;

(8) checking the credentials provided against other sources eg website, letterheads and phone records;

(9) entering into a written contract with the labour provider.

68. Many of the leaflets contain cautions similar to the following that appears in the February 2016 edition:

> "**Other checks and considerations**
>
> HMRC is unable to tell you exactly what checks you should undertake. The examples contained in this notice are only guidelines for the kind of checks you could make to help you avoid dealing with high-risk businesses and individuals.
>
> The checks you will need to make, and the extent of these, will vary depending on the individual circumstances. You should ask the most appropriate questions required to protect your business in the particular circumstances of your individual transactions.
>
> Production of a definitive checklist would merely enable fraudsters and those willing to turn a blind eye, to ensure that they can satisfy such a list."

69. This shows that the checks detailed are not a checklist. In any case, there is no requirement *per se* to do due diligence. The extent to which due diligence is done is a relevant factor which we take account of, mindful of what Moses LJ said at [82] in *Mobilx*.

Visits by HMRC to CCSL

70. HMRC say that prior to the periods under appeal, HMRC Officers carried out the following visits to CCSL or its representatives:

4 November 2011

71. HMRC's note of this visit records:

> "Explianed to Mr Cheema and Mr Akhbar that HMRC (SI) had concerns regarding tax losses in supply chains - some of which the company was a part of. Trader and accountant both acknowledged that they had received veto letters. Mr Akhbar stated that he had attempted to verify all LPs with Coventry but was not impresed with the service he had received.
>
> Expalined that Due Diligence went further than verification with HMRC - confirmed traer in receipt of DD notice and suggested various other checks - e.g. visits to suppliers premises, credit checks, trade references and contracts stating that taxes must be accounted for by supplier." [sic]

72. In evidence, Mr Cheema agreed that HMRC's note of the meeting was correct; a concession that appeared to be in conflict with paragraph [112] of his witness statement which asserted that:

> "CCSL was never informed that HMRC expected due diligence to go further than simply verifying a company's status with HMRC and on Companies House."

73. When questioned about this conflict, Mr Cheema appeared to explain the matter by saying he had been "confused" when preparing his witness statement – a document that he further explained had been drafted with the assistance of his representatives, Kangs.

74. We note however that the note of the meeting does not specify an author. Nor does it record which officers attended the visit. Officer James was unable to address this lack of detail. This somewhat reduces the weight we attach to this note.

7 October 2013 and 22 November 2013

75. These meetings relate to an enquiry into CCSL's gross payment status.

76. In relation to the enquiries undertaken by Officer Tilsar, HMRC conceded there was no evidence before the Tribunal sufficient that it could conclude that any of the earlier supplies were connected with fraudulent evasion of VAT and made clear that HMRC was not inviting the Tribunal to make that finding.

77. Further, Mr Cheema made clear that he considered that Officer Tilsar had adopted a flawed approach and reached incorrect conclusions and yet HMRC filed no evidence from Officer Tilsar in relation to their investigation.

78. We place limited weight on these visits as they appear to have concerned an enquiry into CCSL's gross payment status, rather than VAT.

23 September 2015

79. HMRC produced a note of a meeting at the Hilton Hotel, Manchester Airport, where the following are said to be present:

> "Present : Ken Robinson (London Tax Investigations) for First Choice Employment and Cheema Constuction. Paul Stewart and Joanne Neeson (HMRC)."

80. The note begins:

> "Mr Stewart confirmed that the meeting was not being recorded electronically. He explained the involvement of the Northern Ireland team in these cases due to their specialism in cases of suspected tax abuse in the construction industry. He said the purpose of the meeting was to address the vat position regarding subcontractors. Mr Robinson asked whether both companies were being viewed in the same light. Mr Stewart acknowledged that there was differences in that in the case of First Choice almost every subcontractor had defaulted whilst Cheema, who had also used defaulters, had also engaged legitimate subcontractors."

81. In relation to the meeting at the Hilton Hotel, Officer James accepted that (beyond HMRC's own meeting note) he had no evidential basis to support that Ken Robinson attended that meeting as a representative of CCSL (eg a letter from HMRC addressed to CCSL suggesting a meeting on that date) and had no evidence at all that Mr Robinson had passed any information obtained at (or following) that meeting on to CCSL. Officer James accepted that it would be odd for HMRC to discuss the affairs of two separate taxpayers at a single meeting (as seemed to be suggested by the note). Officer James could not explain why, despite Mr Cheema making clear in his statement that he did not accept that Mr Robinson attended on CCSL's behalf, the officers present at the meeting were not giving evidence or why he had not approached Mr Robinson.

82. Mr Cheema's evidence was that he had no knowledge of the Hilton Hotel meeting or what was discussed and Mr Robinson did not attend as a representative of CCSL. Mr Cheema was not challenged on this during cross examination.

83. In light of the foregoing we place little weight on the note of this meeting. We especially approach it with caution as it appears (as Officer James admitted) highly irregular for two taxpayers to be discussed at one meeting, due to issues of taxpayer confidentiality.

Mr Cheema's attendance

84. Mr Cheema only attended the first of these visits, professional representatives attended thereafter. HMRC observe that this was despite HMRC repeatedly stating that they wished to meet with Mr Cheema personally. Specifically, HMRC note:

(1) A letter dated 29 August 2013, from HMRC trying to arrange a meeting, stating within the first paragraph "Mr Cheema's attendance is required." That meeting took place on 7 October 2013. In evidence, Mr Cheema was unable to explain why he did not attend, stating – "I can't remember." According to HMRC's note, the representative who attended (Mr Geldard of Accountax) was unable to provide HMRC with any useful information. The note of meeting records he:

> "only had a brief chat with director and so didn't know much about Cheema Construction Services Ltd's activities."

Mr Cheema was unable to explain why, instead of attending himself, he had sent along a representative who knew little of his business and suggested that Mr Geldard had been "confused" in his assertion that he knew little of CCSL.

(2) On 22 November 2013, Mr Geldard again met with HMRC. HMRC's note of the meeting records that this time Mr Geldard himself "commented that Cheema may have to attend an interview to explain the situation." A subsequent note of a telephone call between HMRC and Mr Geldard confirmed that this was relayed to Mr Cheema:

> "I asked whether Cheema was aware that I wished to interview him. Geldard confirmed that was the case and said the meeting would take place at Accountax's Office."

Mr Cheema, in evidence, claimed not to be able to remember being told this.

(3) On 10 March 2014, HMRC wrote to Accountax and sent a copy of the same letter to Mr Cheema personally. The letter again requested to meet Mr Cheema, stating:

> "I re-iterate that I have major concerns about the sub-contractor companies used by CCSL and I need to speak to Mr Cheema about his dealings with them. The director also needs to be aware that I'm reviewing CCSL's CIS gross payment status."

In response to this, in evidence, Mr Cheema stated that he had "left it with" Accountax who were "dealing with it".

(4) On 25 July 2014, HMRC received a letter from a new advisor to CCSL, Martyn F Arthur. This letter appeared to offer a meeting with Mr Cheema, but this offer was retracted by a letter dated 15 August 2014 which said:

> "the taxpayer has confirmed he does not wish to provide HMRC with the information relating to subcontractors."

In evidence, Mr Cheema stated this had been because "I was advised to have it written."

85. HMRC say that this demonstrates clear lack of co-operation, and unwillingness to provide HMRC with the information they sought, which is relevant, particularly, to the question of actual knowledge.

86. We acknowledge this behaviour demonstrates a lack of cooperation with HMRC. However, we find that it is of limited assistance in answering the question before us as it is rather historic, occurring several years before the relevant VAT periods.

87. HMRC also observe that during the course of the investigation that led to the *Kittel* denial, an additional unannounced visit took place on 11 April 2022. On this occasion CCSL was noted to have no physical presence at the PPOB, which was a shared spaced used by multiple companies mainly as a mail storage facility. We accept Mr Cheema's explanation that he downsized during the pandemic, as he did not need the full-office premises he had before and the landlord was willing to take them back. We accept that in a business where the economic activity essentially takes place on the building sites, there is limited need for extensive physical premises.

Extent of due diligence

88. HMRC say that the due diligence carried out by CCSL on Woodside was wholly inadequate, having regard to the information they had provided to Mr Cheema.

Documents

89. At paragraphs [83] to [91] of his witness statement Mr Cheema details due diligence he asserts that he carried out on Woodside.

90. The due diligence carried out by CCSL on Woodside consisted of:

(1) a CIS verification check;

(2) a VAT check dated 15 November 2019;

(3) Woodside's company induction pack including, VART Certificates, PAYE reference numbers, ID documents of the director;

(4) business insurance documents for Woodside: Employer Liability Insurance (Page 381) and Public Liability Cover;

(5) copy of Woodside's paying-in book;

(6) blank Woodside timesheets; and

(7) a document erroneously dated "4th August 20201" purporting to provide confirmation that Woodside had correctly accounted for VAT. This document was supplied to HMRC by email, dated 13 May 2022, following the *Kittel* denial.

91. Mr Cheema also has provided a copy of CCSL's contract with Woodside. HMRC note that the contract was also not produced to HMRC until witness evidence was served. Indeed initially CCSL had only supplied HMRC with a CIS verification check confirming that Woodside had gross payment status and a VIES check dated 15 November 2019. However that does not negate the fact that there was a written contract. We accept that some reliance can be placed on the documents, although the weight attached to the contract is limited by the fact that it was not produced to HMRC until witness evidence was served.

Visits by Mr Cheema to premises of suppliers

92. Mr Cheema was asked whether he had carried out visits to the business premises of any suppliers. His initial answer was: "Most of the suppliers I went to see." This was then qualified to exclude perhaps the "first 2 or 3." He was then asked whether he maintained this answer and he replied: "I cannot remember. I did my best to go to all of them." When then asked about seven specific companies, including Woodside, it appeared that he had not, in fact, visited any of them. Rather, Mr Cheema's evidence then became that he "might have

driven past" these companies; and when asked if he accepted that simply driving past an office was not adequate due diligence he replied that "it is to me."

93. HMRC contend that this speaks volumes in relation to both the reliability of Mr Cheema as a witness, and also to his attitude towards due diligence. HMRC suggest it should be inferred that CCSL and Mr Cheema knew that the deals were connected with fraud, and as such that there was no need to carry out robust commercial checks.

94. We find Mr Cheema's evidence on the issue of visits showed a lax attitude towards due diligence. Alone that is insufficient to make a finding of knowledge. But we take account of this in our holistic assessment. However, in an industry such as construction labour supply, we consider that visits to premises are potentially less informative than in other industries (as the economic activity takes place on the building site rather than on the premises). This is a reason to place less weight on the issue of visits.

Woodside Directors

95. We note that Mr Cheema obtained the ID (driving licence) of the director of Woodside, Mr Gurbinder Singh.

96. In evidence, Mr Cheema stated that he had met Mr Singh, in person on a building site in "April or May" of 2019. Woodside was incorporated on 13 May 2019 and therefore, at best, this was when Woodside was a brand-new company. HMRC say the assertion that Mr Cheema had met Mr Singh in person was not one that was apparent from his witness evidence which made no reference to a meeting in person but instead used the opaque descriptors of "approached" and "interaction." Mr Cheema stated in his evidence he was not great at English and so required help from his lawyers in preparing his witness statement. Accordingly, we place little weight on such minor linguistic niceties.

97. Prior to this first interaction Mr Cheema had not known of Mr Singh. However, his evidence was that he had ascertained: that Mr Singh had previously been a supervisor in relation to concrete works; that this was Mr Singh's first company; and that Woodside traded from Mr Singh's residential flat. Mr Cheema said that he had friends, Nick Singh and Armindah Singh from "the Medway area" who knew of Mr Singh and the fact he had set up a labour supply company. No statement was provided from either friend, nor did either appear to have given a substantive reference beyond the fact that Mr Singh did indeed have a new labour supply company. No other references were obtained, and Mr Cheema agreed that he had not approached other companies that Mr Singh had claimed that Woodside had supplied workers for.

Discussion on Due Diligence

98. Having initially stated that he considered CCSL's due diligence to be lacking, Officer James during cross examination stated that was his view at the time of the decision but he now accepted that CCSL had conducted reasonable due diligence in relation to Woodside. In re-examination, the officer was asked "to be clear" as to whether he really meant what he had said, and at that point sought to row back from his concession. In any event, the reasonableness of the due diligence is ultimately a question for the Tribunal.

99. In cross-examination it was not put to Mr Cheema that the due diligence described in his witness statement had not in fact been conducted contemporaneously with the Woodside purchases. Rather, cross-examination was conducted on the basis that the due diligence was lacking because it had not followed all of the recommendations in the Labour Providers Guidance. However, the guidance is just that – there is no legal requirement to conduct due diligence at all and certainly no requirement to undertake each and every check suggested in the guidance. HMRC adduced no evidence to support that the checks suggested in that

guidance are commonly undertaken in the legitimate labour supply sector. Mr Cheema explained in his witness statement what due diligence CCSL conducted. In cross examination he maintained these were reasonable and explained why he had not felt the need to conduct further checks (for example, he was asked whether he had checked Woodside's GLA approvals but explained that such approvals are not required in the construction sector). In any event, HMRC did not establish that, had other (reasonable) checks been done, CCSL would/should have concluded that the only reasonable explanation for Woodside's supplies was connection to fraudulent evasion of VAT. We accept that parts of due diligence may have been lax. But HMRC have not shown, on balance of probabilities, that the due diligence conducted establishes actual knowledge.

Other indicators of contrivance

100. HMRC's skeleton argument also points to the following as indicators of contrivance, which they say (see [54] above) are additional pointers to Mr Cheema knowing the transactions were connected with fraud:

Payments pre-dating invoices

101. Officer James sets out his analysis of CCSL's payments to Woodside. This includes the fact that on 10 occasions, CCSL made payment to Woodside prior to the date of the corresponding invoice. Other suppliers were not paid early.

102. When asked about this discrepancy, and why he was not paying the other providers early, Mr Cheema initially responded that it was because the other suppliers allowed 30 days for payment. We found that answer unconvincing, since Woodside's invoices also provided 30 day payment terms.

103. Mr Cheema then explained that Woodside were CCSL's largest supplier and he therefore wanted to keep them happy. He explained that he knew how much to pay even prior to receiving an invoice, because he would put together the time sheets which he would send to Woodside to attach to the invoices. We find that plausible.

104. Further, we do not see why pre-payment should be an indicator of fraud. Officer James could not explain why making an early payment furthered or was otherwise indicative of VAT fraud. We find that HMRC have not established that paying a regular, major supplier prior to receiving an invoice is an indicator of knowledge (actual or constructive) of fraud. In this case we find the likely explanation is that it is simply a commercial decision taken to maintain a good relationship with a supplier.

Limited information on invoices

105. HMRC say invoices supplied by Woodside lack information when compared to other labour suppliers and do not include, name of the workers, address of site, hours worked, description of the role undertaken and do not include bank details.

106. Further HMRC say the description provided on the face of the Woodside invoices was simply: "labour supplied at various sites." The detail of the information was then supplied by Mr Cheema himself within the list of workers that sat behind each invoice. In this way, the form of the invoices differed from those supplied by labour suppliers accepted by HMRC to be legitimate in that they set out the basis upon which the sums invoiced for were due.

107. Furthermore, HMRC say Woodside's invoices contained basic errors such as the misspelling of cheque ("check"); the date on the invoice did not change when Woodside changed its registered address on 17 February 2020, until some 3 months later; and on invoices from 20 May 2020 the VAT number appeared twice.

108. However, in relation to the detail on the invoices: Officer James accepted that the Woodside invoices (and the time sheet attached thereto) contained materially the same information as the "legitimate supplier" invoices.

109. We do not consider the fact that Mr Cheema supplied the list of workers to be itself a relevant indicator. Nor do we consider there is any reason to believe the typographical and address errors are an indicator of fraud: we consider they could as likely occur on invoices from a "legitimate supplier".

No evidence of negotiation

110. HMRC say in their skeleton that there is no evidence provided that CCSL showed any interest in negotiating the prices that they either paid or charged for the provision of labour, and showed no interest in the actual completion of the construction work to which the transactions related.

111. We disagree. Having been taken to various documents exhibited by Mr Cheema, Officer James accepted that (1) they showed negotiation with customers and (2) he did not stand by the contention that CCSL "showed no interest in the actual completion of the construction work to which the transactions related". We agree.

112. We note it was not put to Mr Cheema in cross-examination that CCSL had not negotiated with customers or that CCSL "showed no interest in the actual completion of the construction work." We find that he did – indeed he said that the reason he continued to use Woodside after it was deregistered was because he wanted to complete the project on-time and satisfactorily.

Length of transaction chains

113. In the transactions at issue in this appeal, HMRC alleged CCSL obtained labour from a buffer company who in turn obtained that labour from its own supplier (one of the Fraudulent Defaulters).

114. HMRC say this appears unnecessary, as there is no commercial basis for a buffer company. There is no reason to believe that CCSL could not simply have gone directly to one of the Fraudulent Defaulters itself to obtain the labour supply. It is not clear what added value these extra members of the chain provide. This is suggestive of contrivance in the transaction chains.

115. HMRC say that Mr Cheema must have known of the Fraudulent Defaulters since:

(1) in his witness evidence Mr Cheema stated that he believed Woodside had "around 15 to 30 workers on payroll", yet the schedules attached to invoices showed variously 32, 34, 34, 33 and 31 workers being supplied each week. Commercially, taken at face-value, CCSL had decided to use a labour-supplier who did not have the resource to supply its needs.

(2) There was no evidence of negotiations, despite workers being charged out at different rates. the evidence was that Mr Cheema prepared a document that was then sent to Woodside, and from this Woodside raised an invoice to CCSL. The document prepared by Mr Cheema was identical in form for each invoice and set out for the given week the worker's name, hours worked, rate of pay, and total payment. Thus, for each week, Mr Cheema needed to know the agreed rate of pay for each of the thirty plus workers; some of whom were different week-to-week.

(3) Some of the workers' names (Dharminder Singh, Kamaljit Bassi and Sukhdev Singh) appearing within the list of workers attached to each Woodside invoice matched the names of workers who had previously worked with CCSL in 2015. HMRC say this

was apparent from questionnaires sent in 2015 to the workers in relation to the removal of CCSL's GPS status where those workers stated they were, in fact, CCSL's workers. HMRC had also formed that view.

116. Mr Cheema accepted that Kamaljit Bassi was the same worker who had completed a questionnaire in 2015, but said Dharminder Singh and Sukhdev Singh were common names and different people. He explained that Singh was a common name, as it indicated a person was a baptised Sikh.

117. Mr Cheema said that he had asked "a few" workers who paid them: they answered Woodside.

118. Officer James accepted that there was no evidence that CCSL knew Woodside was buying labour from another entity and no evidence that CCSL knew who that other entity was. Despite Officer James' concession, it was put to Mr Cheema several times in cross-examination that he knew Woodside was buying labour from someone else (although it was not put that he knew the identity of the Fraudulent Defaulters). Mr Cheema denied that, saying that when he spoke with the workers, they told him that they were Woodside workers. Mr Cheema was not challenged on this evidence (ie it was not put to him that the workers had not said this to him). HMRC have not obtained the workers' payslips so cannot say who was named as the paying party.

119. With regard to (1) we find the difference between Mr Cheema's upper recollection of 30 and the numbers of Woodside workers he used minimal. We place little weight on this.

120. With regard to (2) Mr Cheema said in evidence negotiation with the labour suppliers occurred over the telephone. He was not challenged on this during cross-examination.

121. With regard to (3) Mr Cheema denied this and explained that the these were different individuals and that these names were commonplace. HMRC took no steps to ascertain whether they were the same individuals (or, as Mr Cheema contended, simply different people that shared the same common name). In any event, it is far from clear why, even if they were the same individuals it follows that Mr Cheema knew that Woodside was buying their labour from Fraudulent Defaulters. HMRC withdrew the suggestion that it was Mr Cheema who was "using defaulting traders to employ your regular workforce".

Level of fraudulent transactions

122. HMRC say in all of the VAT periods in which input tax is being denied, the amount of input tax being denied is between 98% to 100%, with 5 periods showing 100% attributed to supplies of labour. They say this substantial proportion shows a pattern of trading in relation to the purchase of labour which would be unlikely to occur unless there was contrivance.

123. We disagree. While this might be the case if CCSL had several suppliers of labour, given the fact that in the relevant periods Woodside provided either all or the vast majority of the relevant labour, we do not consider such percentages to be a significant consideration.

Payments made to Woodside after deregistration

124. Notwithstanding the fact that CCSL was informed that Woodside had been deregistered for VAT, with the Dereg Veto Letter referencing "increasing problems with fraud and unpaid taxes with businesses that act as labour providers" and providing a link to the HMRC leaflet *Use of Labour Providers – Advice on due diligence*; CCSL continued to make payments to Woodside for a further 3 months, until 29 October 2021. At paragraphs [281], [298] and [299] of his witness statement Mr Cheema accepted that CCSL continued to trade with Woodside after it had been deregistered for VAT but asserts that all payments were then made exclusive of VAT. HMRC do not dispute that no VAT was paid, but question why Mr

Cheema would choose to continue to trade with a company that had been deregistered for VAT and to thereby disregard the risk of any potential CIS misuse that the business may be involved in.

125. In evidence, the explanation offered by Mr Cheema was that he "needed labour" and when asked why he did not source this elsewhere he replied:

> "those workers were used to the conditions, health and safety. The workers completed the work to a good standard. It looks silly inducting lots of new people. I took the brave decision. As long as I don't pay VAT it should be fine."

126. HMRC say this suggests Mr Cheema's actual knowledge of the fact that he was trading in tax loss chains. Such knowledge is consistent with the fact that Mr Cheema was instantly willing to continue to trade with a business in circumstances in which it had been deregistered; simply taking the step to mitigate against his own potential loss by not paying over the VAT, but still paying Woodside gross in respect of the direct tax deductions and therefore continuing to trade putting direct tax revenue at risk.

127. We consider it more likely, as Mr Cheema explained, he simply wanted to complete the project. He understood the deregistration related to VAT and so he did not pay VAT to Woodside, to ensure that there was no VAT loss.

Knew or should have known

128. The information sent by HMRC to Mr Cheema (discussed at [54] to [69] above) will have alerted him to the fact that there was a risk of fraud in the construction labour supply sector. These include 12 Dereg Veto Letters, 10 of which were sent before the relevant period, and various iterations of HMRC's leaflet on advice on due diligence regarding labour providers. Indeed Mr Cheema admitted he has aware of this. But as Officer James conceded there is a significant legitimate labour supply industry.

129. Much of the evidence presented by HMRC has been historic, rather than particular to the relevant period of assessment. This includes what we accept to be a lack of cooperation with HMRC around 2013, when Mr Cheema seems to have avoided meeting them in connection with an enquiry into gross payment status under the CIS. As such it has limited weight in relation to the VAT under appeal in this case.

130. Also, with regard to the Dereg Veto Letters, HMRC did not adduce evidence to demonstrate that the earlier supplies looked, from CCSL's perspective, sufficiently similar to the Woodside supplies as to mean that any concerns raised about these earlier purchases should have caused CCSL to conclude that the Woodside supplies were not part of the legitimate labour supply industry.

131. We have discussed above (at [100] to [127]) what HMRC have suggested to be indicators of contrivance. These include payments pre-dating invoices, limited information on invoices, no evidence of negotiation, the length of transaction chains, the level of fraudulent transactions and the payments made to Woodside after deregistration. However, for the reasons we set out above, we do not consider, viewing all the evidence in the round, that these (should we be wrong on connection) show that CCSL knew or should have known that the transactions were connected to fraud.

132. It was clear that Mr Cheema had a lax attitude to some parts of due diligence (considered at [88] to [91] above). This was shown particularly by his testimony in relation to visits of premises, where he suggested driving past could be due diligence. But it is clear from the level of due diligence conducted in relation to Woodside that CCSL did adjust and develop its processes over time. However, as made clear at paragraph [82] of *Mobilx*, the

Tribunal should not unduly focus on due diligence. It is simply one feature that can be weighed in the balance when considering whether a taxpayer knew or should have known that its purchases were connected with the fraudulent evasion of VAT.

133. So viewing all the evidence in the round, we do not find HMRC have shown (should we be wrong on connection) that CCSL knew that the transactions were connected to fraud.

134. We do not find that HMRC have shown that the only reasonable explanation for circumstances surrounding CCSL's transactions with Woodside was that they were connected with fraud.

135. Nor (again, should we be wrong on connection) viewing the evidence in the round, do we find HMRC have shown that CCSL should have known on balance of probabilities that the transactions were connected to fraud.

Penalties

On the basis of our finding that the appeal against the *Kittel* denial should be allowed, it follows that the appeal against the penalties must also be allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

136. 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.

Release date: 28th JANUARY 2025