Neutral Citation: [2025] UKFTT 296 (TC)

Case Number: TC09446

FIRST-TIER TRIBUNAL
TAX CHAMBER

Centre City Tower, Birmingham

Appeal references: TC/2022/00623
TC/2022/01584

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

Heard on: 13 – 15, 17 January 2025
Judgment date: 07 March 2025

Before

TRIBUNAL JUDGE BLACKWELL
TERRY BAYLISS

Between

PROMERIDIAN SERVICES LIMITED

First Appellant

MR LEON MARIAN

Second Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Robert Morris, instructed by KANGS Solicitors.

For the Respondents: Ms Charlotte Brown of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. Promeridian Services Limited ("Promeridian") was incorporated on the 11 February 2019 and registered for VAT on the 1 September 2019. Mr Marian was the sole director and shareholder of Promeridian. The nature of its business started with commercial glazing but progressed to doing cladding, drylining and commercial interiors.

2. Total Construct Services Limited ("TCS") supplied Promeridian with labourers for the periods in question. The director of TCS was Mr Oleg Tonica. TCS was Promeridian's sole supplier of labourers during this period. It is common ground that TCS did not properly account for VAT received from Promeridian, that this led to a tax loss and that this was as a result of fraudulent behaviour on the part of TCS. Specifically, TCS inflated its own input tax and did not keep proper records. Further it went missing and defaulted after the period in question.

3. At all material times Mr Marian was the sole director and shareholder of Promeridian.

4. Mr Marian is a 42 year-old man who has worked in the construction industry since 2012. His expertise is specifically managing glazing and cladding projects. Having obtained expertise in this area he has changed from a construction worker himself to an individual who oversees such projects.

5. This appeal is against the following decisions:

   (1) a decision dated 15 March 2021 to deny input tax of £559,896.00 for purchases of labour across VAT Returns 02/20, 05/20, 08/20 and 11/20 using the *Kittel* principle (the "*Kittel* Decision");

   (2) a decision dated 15 March 2021 to compulsorily deregister Promeridian from VAT using the *Ablessio* principle ("the "*Ablessio* Decision");

   (3) a decision dated 14 April 2021 to issue a section 69C VAT Act 1994 ("VATA 1994") penalty against Promeridian for £167,968.00, being 30% of the input tax denied under *Kittel* (the "Company Penalty"); and

   (4) a decision dated 23 February 2022 to make Mr Marian personally liable for the section 69C penalty under section 69D VATA 1994 (the "PLN").

6. In addition to the oral submissions, we have also had the benefit of skeleton arguments and written closings from HMRC and the appellants.

ISSUES TO BE DETERMINED

7. As confirmed in the Appellants' Response to the Fairford Directions, the only aspect of the *Kittel* Decision that is in dispute is whether the Appellant had the requisite knowledge or means of knowledge. Therefore, the issues to be determined by the Tribunal are:

   (1) Whether Promeridian knew or should have known that its transactions with Total Construct Services Limited ("TCS") were connected to fraud;

   (2) Whether there were objective grounds for considering that it was probable that Promeridian's VAT registration number had been or would be used fraudulently and therefore it should be deregistered from VAT;

   (3) Whether Promeridian is liable for the Company Penalty;

   (4) Whether the activities that gave rise to the Company Penalty were attributable to Mr Marian (it not being in dispute that he was, at all material times, an officer of the company) so that he is liable for the PLN.

8. Whilst the legal tests are different, it is agreed by the parties that in the particular circumstances of this case the appeals on the *Kittel* Decision and the *Ablessio* Decision would stand or fall together.

9. 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 two witnesses and hearing bundle, and then apply the legal framework to those facts.

THE LAW

The right to deduct input tax

10. 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).

11. 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).

12. 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

13. 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.
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> 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."

14. 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."

15. 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*."

16. 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."

17. 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.
>
> 110. To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> 111. Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

18. 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."

19. 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."

20. 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

21. 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."

22. In *Mahagében kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága; Dávid v Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága* (Joined cases C-80/11 and C-142/11) [2012] STC 1934 the CJEU said the following with regard to due diligence:

> "60. It is true that, when there are indications pointing to an infringement or fraud, a reasonable trader could, depending on the circumstances of the case, be obliged to make enquiries about another trader from whom he intends to purchase goods or services in order to ascertain the latter's trustworthiness.
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> 61. However, the tax authority cannot, as a general rule, require the taxable person wishing to exercise the right to deduct VAT, first, to ensure that the issuer of the invoice relating to the goods and services in respect of which the exercise of that right to deduct is sought has the capacity of a taxable person, that he was in possession of the goods at issue and was in a position to supply them and that he has satisfied his obligations as regards declaration and payment of VAT, in order to be satisfied that there are no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction or, second, to be in possession of documents in that regard.
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> 62. It is, in principle, for the tax authorities to carry out the necessary inspections of taxable persons in order to detect VAT irregularities and fraud as well as to impose penalties on the taxable person who has committed those irregularities or fraud.
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> 63. According to the case law of the court, member states are required to check taxable persons' returns, accounts and other relevant documents (see *EC Commission v Italy* (Case C-132/06) [2008] ECR I-5457, para 37, and *Dyrektor Izby Skarbowej w Biaymstoku v Profaktor Kulesza, Frankowski, Jówiak, Orowski* (Case C-188/09) [2010] ECR I-7639, para 21).
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> 64. To that end, Directive 2006/112 imposes, in particular in art 242, an obligation on every taxable person to keep accounts in sufficient detail for VAT to be applied and its application checked by the tax authorities. In order to facilitate the performance of that task, arts 245 and 249 of that directive provide for the right of the competent authorities to access the invoices which the taxable person is obliged to store under art 244 of that directive.

> 65. It follows that, by imposing on taxable persons, in view of the risk that the right to deduct may be refused, the measures listed in para 61 of the present judgment, the tax authority would, contrary to those provisions, be transferring its own investigative tasks to taxable persons."

23. 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*").

24. 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]

25. 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

26. 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) the appellant's purchases on which input tax have been denied were connected with that fraudulent evasion of VAT; and

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

27. 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.

28. It is not enough for HMRC to prove that the appellant's purchases *might* have been connected with fraudulent evasion of VAT: see *Hira Company Ltd v HMRC* [2011] UKFTT 450 (TC) at [111], per Judge Poole. Rather, HMRC have to prove, on the balance of probabilities, that the appellant's purchases *were* connected with fraudulent evasion of VAT.

29. Similarly, it is not enough for HMRC to prove that the appellant 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 the appellant knew or should have known that its purchases *were* connected with fraudulent evasion of VAT.

30. 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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> …
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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."

EVIDENCE

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

    (1) Officer Whitehouse, an HMRC officer employed within the Fraud Investigation Service, Cardiff; and

    (2) Mr Marian, who gave his evidence through a Romanian interpreter.

32. We have also considered the evidence contained in an electronic bundle of 2,020 pages.

FINDINGS OF FACT

33. We found Officer Whitehouse to be a reliable witness who frankly answered questions that were put to him, including giving responses that were detrimental to HMRC's case. We therefore found him to be a honest and reliable witness.

34. We found Mr Marian to be an unreliable witness with regards to parts of his testimony, for the reasons stated at and around paragraphs [49], [62], [71] and [95] of this Decision. We are however conscious that a witness may be reliable on certain matters, but not on all matters. However the impression we took from his evidence was that he had a detailed memory of events and was willing to deploy that knowledge by giving a detailed account to the Tribunal when it suited him to do so.

35. We comment on particular items of evidence below, however we find it convenient at the outset to discuss the record of Mr Marian's meeting with HMRC on 12 February 2021. This meeting took place on the telephone. Although HMRC accessed the phone through their laptops there was no video aspect to the meeting. A translator was present, however aspects of the translation appear to have been poor. This is evident from numerous paragraphs that were brought to the attention of the Tribunal, such as where it is noted that the "answer did not translate well" or Mr Marian says "I cannot answer because I do not understand the question."

36. Mr Marian was not provided with a copy of the minutes of the meeting until they were disclosed for the purposes of this litigation.

37. We note also that Mr Marian was unaccompanied at the meeting. Mr Marian had initially anticipated that his accountant would join him on the call, however the accountant left the call before Mr Marian joined, due to child care issues. However Mr Marian still anticipated that the accountant would be there because he stated at the start "the accountant could speak for a bit".

38. We accept that Mr Marian was willing to go ahead with the call in the absence of his accountant. Initially Mr Marian thought that the meeting would be face-to-face and stated that his accountant would not be able to join him, as he was in Manchester, and COVID restrictions would not have allowed him to come to Birmingham. However when it was explained that the meeting was to be online, he wished the accountant to be there. The absence of the accountant meant there was no one to speak up for Mr Marian when there were issues of translation, which from the record there appears to have been.

39. Due to the poor translation of parts of the record of the meeting we do not consider it to be a reliable document, especially given the technical nature of the issues discussed.

40. Relevant to whether the Appellants had the requisite knowledge is Mr Marian's background knowledge of the extent of fraud in the construction industry. HMRC say that he would have this knowledge from his work in the UK construction industry since 2015. However, until he started Promeridian he was a worker and so not involved in financial matters. When asked about his knowledge of construction industry fraud in cross-examination he cited Carillion, however that was not a VAT fraud. Promeridian was not sent any warning or guidance relating to VAT fraud until 15 October 2020, a year into its dealings with TCS. Mr Marian admitted he would have been able to understand the gist of the letter, despite it being in English, although he may have struggled with the more technical parts. The warning did not specify TCS and recommended a telephone meeting to discuss the business activities of Promeridian and to "help both your business and HMRC". This meeting did not happen until the 21 February 2021. At that meeting he said he did not know what missing trader fraud was, and no explanation was given by HMRC. Further, the evidence suggested that Mr Marian's accountant was not aware of *Kittel* or missing trader fraud. Thus, aside from the evidence (which we discuss below) that supports HMRC's case that Mr Marian knew of the VAT fraud perpetrated by TCS, there is little evidence to show that the Appellants had a significant knowledge of the level of VAT fraud in the construction industry.

41. The Appellants say that it is relevant to the issue of commerciality that Promeridian provided services to legitimate customers. They dealt with a large number of different projects and a large number of different customers, including Pacegrade Ltd, Taylor Hart Ltd, Yesero Ltd, Glade Construction Ltd, Intastruct Ltd, Flynn Interiors Ltd, TC Interiors Ltd, BPC Interiors Ltd, Skylion Project Limited, Stonegate Land and Property Limited and Dotcom Glazing Limited. This is relevant to the issue of commerciality, however its relevance is somewhat limited as HMRC do not plead any collusion with customers. More relevant to the issue of commerciality is that Mr Marian and Promeridian were able to complete a large number of projects to the satisfaction of their clients using TCS. This is a significant indicator that TCS seemed to be a functioning operational business, supporting the Appellants' case that their relationship with TCS formed part of a genuine commercial transaction.

42. HMRC rely upon the following objective factors which they say prove the Appellants had the requisite knowledge:

(1) rapid increase in turnover in the first year of trading;

(2) fortuitous timings with TCS;

(3) prior contact with Mr Tonica;

(4) lack of formal contract with TCS;

(5) control;

(6) profit margin;

(7) insurance;

(8) basic errors on TCS invoices;

(9) trading with TCS despite being notified of their VAT deregistration; and

(10) lack of meaningful due diligence.

43. We consider each of these factors in turn in the following subsections, before turning to stand back and consider the totality of the evidence. As the burden of proof is on HMRC we

structure the following paragraphs by first stating HMRC's case and then considering HMRC's case, taking account of the submissions of the Appellants.

Rapid increase in turnover in the first year of trading

HMRC's case

44. HMRC's case is that Mr Marian was initially a construction worker on sites with no prior commercial experience of running a construction business or sourcing workers to work for him. He did not have a large start-up capital, using £2,000 to £3,000 of his savings to purchase the Public Liability and Employer's Liability Insurance. By his own evidence, he was unable to source his own workforce due to not having the financial means to pay for them. This was obviously an issue, as projects required a workforce to carry out works in order to get paid. During oral evidence, he accepted that he had little or no income when he first started Promeridian.

45. Promeridian's application for VAT registration stated that estimated turnover in the first year was £400,000. In fact, Promeridian's turnover in the first year was significantly more than that, reaching just under £3.5m in the first 14 months of trade. The ever-increasing turnover was as follows:

(1) 02/20 net sales £277,580.51 – being the first quarter of trading

(2) 05/20 net sales £818,557.03

(3) 08/20 net sales £933,532.20

(4) 11/20 net sales £1,426,878.21

46. HMRC say the significance of this is that he was able to source labour to supply this ever increasing turnover. They do not place reliance on his ability to source that ever increasing amount of work, as they have not pleaded collusion with the clients of Promeridian.

47. Mr Marian's oral evidence was that he did not source workers from agencies as they were not the right quality and were too expensive. All the labour was sourced from TCS.

Discussion

48. Whilst we do consider the turnover in the first year to be remarkable, we consider what is remarkable about it is that Promeridian was able to source so many clients. We were told that this was due to Mr Marian's contacts within the industry. Nonetheless, we find this very unusual that business would expand at such a rapid rate. We also find it implausible that Mr Marian was able to use his contacts to find clients but not to find other labour providers. Mr Marian's oral evidence was that his contacts were with clients. However, this contradicts his witness statement where he says "I became well acquainted with other workers, supervisors, and contractors in the industry". [our emphasis]

49. We consider this a reason to find Mr Marian an unreliable witness with regard to parts of his evidence.

50. However, we do not consider it particularly remarkable that he was able to get labour supplied by TCS. This is because TCS used self-employed contractors as labourers, rather than an employed workforce, so would have been able to respond fairly rapidly to increased demand.

51. Accordingly, other than contributing to our view of the reliability of Mr Marian, we do not consider this to be a significant factor.

Fortuitous timings with TCS

HMRC's case

52. TCS was incorporated in April 2019 and registered for VAT with an effective date of 1 October 2019. Promeridian commenced trading with TCS in October 2019.

53. HMRC say that the fact that TCS was able to supply workers of the requisite quality and price at the early stages of its trading and was able to continue to fulfil Promeridian's ongoing projects seemingly without issue is simply not credible.

Discussion

54. We do not consider this to be a significant factor. As we have already noted, TCS used self-employed contractors as labourers, rather than an employed workforce, so would have been able to respond fairly rapidly to increased demand.

Prior contact with Mr Tonica

HMRC's case

55. HMRC's case is that despite claiming that he did not know Mr Tonica very well, speaking to him infrequently on the telephone between 2015 and 2019, Mr Marian's oral evidence was that Mr Tonica requested that he be able to use Mr Marian's residential address ("794PR") as a correspondence address for Mr Tonica's National Insurance number correspondence and "important documents."

56. HMRC's TBS systems which reflect personal taxes for taxpayers, show that Mr Marian was registered as being resident at 794PR between April 2015 and February 2017, and Mr Tonica is registered as being resident there between May 2017 and October 2017. This is explained in §16 of Officer Whitehouse's witness statement, which was not challenged.

57. Mr Marian stated in oral evidence that he also permitted Mrs. Tonica, Mr Tonica's wife to use his subsequent address ("32CR") for similar purposes, where he lived with his family, and which was also the registered address of Promeridian.

58. HMRC's unchallenged evidence at §19 of Officer Whitehouse's witness statement shows that Mrs. Tonica was registered on HMRC's PAYE system as residing at 32CR from 10 July 2019 to 1 April 2022, which overlaps with Mr Marian's period of residence there.

Discussion

59. Mr Marian said in evidence that he met Mr Tonica in 2015, when they both worked on a building site. At that time they were both workers, not business owners. However Mr Tonica expressed his hope of setting up a labour supply business one day. We accept that to be the case.

60. It is submitted for the Appellant that his acknowledgement of allowing Mr Tonica to use his address enhances the Appellant's credibility. They say Mr Marian did not shy away from admitting doing things which may appear improper. He told the Tribunal he had helped Mr Tonica and indeed other immigrant workers by allowing them to use his address for correspondence when seeking to achieve settled status. We disagree. There was no acknowledgement in Mr Marian's evidence that such conduct was improper. Thus it does not add to his credibility as he apparently lacked the understanding that such conduct might be regarded as improper.

61. Mr Marian explained that he did this because the house in which Mr Tonica lived was a house in multiple occupation. Accordingly Mr Tonica considered that it was not safe to receive important documents there. We accept this is plausible.

62. However we consider that this strongly suggests that Mr Marian and Mr Tonica had a closer relationship in 2017 than was admitted by Mr Marian. Mr Marian suggested they were only acquaintances. Mr Marian also stated that Mr Tonica was a very charismatic individual and a leader of groups. Accordingly, as we raised at the hearing, it is likely that Mr Tonica would have had many other individuals he could have approached. Admittedly some of those, like him, would be living in houses of multiple occupation. However if Mr Marian was only an acquaintance of Mr Tonica, we anticipate there would be many people who would be in a closer relationship to Mr Tonica, and Mr Marian would be aware of this. This therefore suggests to us that the relationship between Mr Marian and Mr Tonica was closer than admitted. This also contributes to our view of Mr Marian as an unreliable witness.

63. Further it seems to us implausible that Mr Tonica would need to have a National Insurance number sent to him in 2017. This is because on Mr Marian's evidence Mr Tonica worked with him on a UK building site in 2015. Mr Tonica would presumably have required national insurance number in 2015. This again causes us to question the reliability of Mr Marian's evidence.

Lack of formal contract with TCS

HMRC's case

64. HMRC's case is that during the meeting of 12 February 2021, Mr Marian stated that he did not have any contracts with TCS. In his witness evidence at §48b he claims that there were oral contracts in place.

65. HMRC asserts that it is not credible that Mr Marian would sub-contract such lucrative work on projects of the scale that Promeridian's customers were involved in without a record of the scope of the agreement and the terms. At its most basic, one would expect to see emails or text messages setting out or confirming the site in question, the specific work required, the number of workers agreed, the relevant dates, and the agreed fee. Given the sums at stake, it is asserted that there would also be written contractual terms in case of any issues or disputes. This is particularly so, given Mr Marian's repeated oral evidence that there were daily issues on sites. Whilst there is minimal evidence of agreements in the bundle between Promeridian and their customers, there is nothing similar between TCS and Promeridian, which are the transactions in dispute. Indeed, the fact that there are confirmatory emails between Promeridian and their customers makes it even less credible that there was nothing between Mr Marian and Mr Tonica.

66. HMRC say Mr Marian's oral evidence was that there would be a large file of documents for each project setting out the scope of the work and the timescale. This would set out the basis of the agreement between Promeridian and TCS. None of these have been provided. Mr Marian's oral evidence was that these were either lost when he moved house or were drawn on by his children. HMRC submits that it is highly unlikely that there was not one example available for this appeal and Mr Marian's evidence is not credible.

67. HMRC say Mr Marian's evidence was very detailed regarding the type of work undertaken and he went into granular detail. Further, he has taken reams of meticulous notes in relation to costings when deciding what to base his fees for Promeridian's customers on, as well as keeping detailed floorplans of the different stages of a project. He confirmed in oral evidence that the latter were from the construction process itself, and were finalised at the end of the project and were not provided to TCS. HMRC submits that given the level of detail of his explanations and the documents retained in relation to his oral dealings with his customers, it is simply not credible that he would not have the same or at least some notes available in relation to his commercial agreements with TCS.

Discussion

68. As noted above, we place little weight on the discrepancy between the interview and Mr Marian's oral evidence. Issues of translation could well have caused him to be recorded as saying there was no contract, when what was meant was there was no *written* contract.

69. Mr Marian's evidence was that he did not contract with the main contractor but either with the contractor who contracted with the main contractor, or the second in line. Accordingly, Mr Marian was some way down the pecking order of contractors. We consider this to be relevant when considering whether a written contract would be the norm. Higher up the pecking order, especially in public sector contracts, we would consider it to be abnormal for there to be no written contract. At Mr Marian's position in the pecking order we consider it plausible that there was no written contract.

70. We also consider it plausible that the large files of paperwork, which he referred to, were disposed of during a house move. That would be an opportune moment to clear out things. Further his testimony that his children had destroyed certain documents by using them as drawing paper was corroborated by one document in the bundle, which we were referred to, which showed pencil lines over it.

71. As we raised at the hearing, we find surprising Mr Marian's testimony that he did not have *any* written contracts with his clients. We find this particularly surprising in relation to public sector contracts: Mr Marian explained that he was involved in building projects for a university and for a hospital. Furthermore, despite his testimony that there were no written contracts with his clients, we were then referred to two examples of written contracts. We consider this to be another reason to find Mr Marian an unreliable witness. However, beyond that we take nothing further from this point: it is not HMRC's case that there is any collusion with clients.

72. Therefore, aside from the issue of Mr Marian's reliability, we do not consider this to be a factor indicating that the Appellants had the requisite knowledge.

Control

HMRC's case

73. HMRC say the issue of control is relevant to commercial rationale. Mr Marian accepted in his oral evidence that it was for TCS to determine how many workers would be allocated to the site and the duration that they would be required for. HMRC say that this is surprising, given Promeridian would have given a quote to its customer by this stage, based upon the anticipated work required and the duration of that work. HMRC also point to inconsistencies in Mr Marian's evidence as to who controlled the site and state they place little evidence on photographs submitted by Mr Marian.

Discussion

74. With regard to who controlled the work on the site, we found Mr Marian's evidence plausible. This was that TCS had supervisors on site who largely dealt with health and safety issues. However Mr Marian was responsible for the delivery of the contract and inspection of the quality. We agree with HMRC that the photographs are of little assistance to the Tribunal: they are not dated and no written narrative explanation was provided with them.

75. However we found Mr Marian gave a detailed account in his evidence which was largely internally consistent. We note that there was some inconsistency with how frequently he met clients, but he noted how the COVID epidemic impacted on this. We note the restrictions in that epidemic fluctuated and so this is a plausible explanation.

76. We consider there was some confusion as to control, due to the circumstances of the interview on 12 February 2021. Officer Whitehouse accepted in evidence that he had mistakenly concluded that reference made by Mr Marian in interview to sites being controlled by the "main contractor" related to TCS. In fact, "main contractor" was a term used by Mr Marian to describe Promeridian's customer and not his supplier. TCS did not have control of any of the sites to which they provided workers. The only discretion retained by TCS concerned how many workers to allocate to sites and their respective pay-scales.

77. We do not consider it particularly relevant that TCS decided on the number of workers to send to the site. That does not show the arrangement was uncommercial. They were the labour provider. Indeed, the fact that Mr Marian did not determine the number of workers might partly explain the varying level of profit on transactions. (See the section "Profit Margin", immediately below.) We understand from the evidence that the transactions were priced by Mr Marian in proportion to the area (in square-meters), but his outgoings were based on man-hours.

78. We therefore do not consider this to be a factor indicating that the Appellants had the requisite knowledge.

Profit Margin

HMRC's case

79. In evidence Mr Marian stated that the profit margin varied from losses to making a profit of 5%. In oral evidence he said it was only a small percentage of jobs where they made a loss. Mr Marian testified that 10% of fees were received from customers, with the balance of 90% being paid to TCS.

80. When it was put to Mr Marian in cross-examination that given the sums coming in from customers by reference to the bank statements, this did not appear to be commercially savvy, his response was that the money was going to workers who had families and he repeated that agencies were expensive and did not have workers of the required quality.

81. HMRC say it does not make any commercial sense to be paying 90% of income to a sub-contractor without considering alternative options. HMRC observe that (as already noted at [48]) Mr Marian was "well acquainted with other workers, supervisors, and contractors in the industry", with whom he could price-check.

Discussion

82. We find this argument tenuous. HMRC presented no objective evidence as to what is the normal profit margin in the construction industry. Clearly the business he was in required labour and that would be the main item of expenditure. Mr Marian's evidence was that the labour supplied was of high quality and good value for money.

83. He stated he had tried speaking to other labour providers and in evidence we were provided with the telephone numbers of two such providers he claimed to have contacted. Clearly just providing telephone numbers is of limited evidential weight. But if HMRC wished to they could have verified these numbers, they did not.

84. We also accept the Appellants' argument that where a business performs well they will get repeat business. There is nothing particularly suspicious about that.

85. We therefore do not consider this to be a factor indicating that the Appellants had the requisite knowledge.

Insurance

HMRC's case

86. Whilst Promeridian had Public Liability and Employer's Liability insurance, Mr Marian confirmed that he did not have any commercial trade insurance to cover losses or bad debts. His reasons for this were that it was too expensive and it was not compulsory.

87. HMRC asserts that the reason that such insurance was not in place is because there were no risks for Promeridian in these transactions, because TCS was always able to fulfil Promeridian's needs. This is confirmed in Mr Marian's witness statement where he states, "TCS always fulfilled the contract provided to it by Promeridian." HMRC say that given Promeridian had a turnover of £3.5m in its first year of trading, such insurance would have been proportionate and commercially prudent.

Discussion

88. We disagree. HMRC have not provided any evidence that it is normal for companies to carry such bad debt insurance. The argument that it would be prudent because of Promeridian's turnover is unconvincing because the cost of such insurance would presumably be proportional to the turnover. Furthermore, as we suggested at the hearing, it might be difficult for a company in its first year of trading to obtain such insurance.

89. We therefore do not consider this to be a factor indicating that the Appellants had the requisite knowledge.

Basic errors on TCS Invoices

HMRC's case

90. HMRC say the invoices that Promeridian received from TCS highlight very basic errors that go towards proving the lack of commerciality in these transactions.

91. First, they are all numbered "INVOICE 1". This is in breach of Regulation 14(1)(a) of the VAT Regulations 1995, which requires an "identifying number". Mr Marian claimed that he raised the numbering with Mr Tonica "many times" but when pushed in cross-examination as to why this was not referred to in his witness statement, and no evidence of this being provided in the bundle, he claimed that he could not remember.

92. Secondly, they all have the identical description of "Total Gross Labour Charges." This is in breach of Regulation 14(1)(g) of the VAT Regulations 1995, which requires an "a description sufficient to identify the goods or services supplied". In evidence Mr Marian accepted that Mr Tonica/TCS could have provided a breakdown of the services on the invoices.

Discussion

93. The basic errors on the invoices from TCS are suggestive that Mr Tonica had a lax attitude to VAT compliance. A recipient of the invoices may thus have been put on alert to this from receiving them.

94. However they are not decisive indicators of a fraud. There is no advantage gained, in terms of perpetrating the fraud, by omitting the correct details. Accordingly, we consider this factor of itself to have some, but limited, weight in indicating that the Appellants had the requisite knowledge.

95. However, we were unpersuaded by Mr Marian's testimony that he raised the numbering issue of the invoices with Mr Tonica. There was no prior indication that he had done so. Further, the invoices seemed to have been created in a word-processed document and so the numbering error could easily have been corrected if it had been brought to the attention of Mr Tonica. The

fact that it was not corrected is suggestive that Mr Marian did not raise the issue with Mr Tonica. We consider this another reason for regarding Mr Marian as an unreliable witness.

Trading with TCS despite being notified of their VAT deregistration

HMRC's case

96. On 17 December 2020 Promeridian was notified that TCS had been deregistered for VAT. Despite this, Promeridian continued to trade with TCS until February 2021. Mr Marian's explanation for this is that Mr Tonica assured him everything was under control and he took a commercial decision to keep trading with TCS to fulfil his contracts with his customers.

97. HMRC say that it is not credible that Promeridian would be unable to source alternative labour from Mr Marian's contacts or agencies to fulfil the contracts with its customers. Mr Marian accepted that deregistration was serious and it is submitted that a prudent taxpayer would have immediately stopped trading with TCS. The fact that TCS continued to claim VAT on its invoices despite being deregistered, would also have alerted a prudent taxpayer to the fact that Promeridian's transactions with TCS were illegitimate. HMRC say it is clear, therefore, that this is strong evidence that Promeridian had actual knowledge of TCS's fraudulent trading.

Discussion

98. We disagree. We accept the evidence of Mr Marian that if he used another substitute contractor to supply labour they would have charged him for close to the full amount of any project, not making allowance for the fact that it was partially complete. Further, getting a supplier at the last minute where Mr Marian could be confident they would supply high quality labour might be problematic. We note that Mr Marian did not pay VAT to TCS on these amounts after TCS was deregistered. Paying TCS without paying any VAT could not further a VAT fraud. This is of itself indicative that there was a commercial transaction taking place. The evidence before us was that these payments, postdating registration, where only to fulfil contracts on existing projects.

99. We note also the evidence of Officer Whitehouse who said that HMRC could not advise a taxpayer to cease doing business with a company who was deregistered. He said it is not for them to give commercial advice like that.

100. We therefore do not consider this to be a factor indicating that the Appellants had the requisite knowledge.

Lack of meaningful due diligence.

HMRC's case

101. HMRC say the due diligence conducted by Promeridian included:

(1) a certificate of incorporation of TCS

(2) a UTR number for Corporation Tax

(3) an employer PAYE Reference

(4) a copy of Mr Tonica's passport

(5) CIS verifications

(6) nine CIS deduction statements for workers; and

(7) two VAT returns (for the periods 02-04/2020 and 05-07/2020).

102. HMRC say that these do no more than confirm the existence of the business and would not assist the Appellants in assessing the risks in dealing with TCS or determining the integrity of the supply chain.

103. HMRC suggest that failing to obtain the VAT return for the period 09-11/2020 is indicative, as that would have shown evidence of the fraud. They also say that the returns do not show tax was paid, only that it was due.

Discussion

104. We consider that, viewed objectively, Mr Marian conducted adequate due diligence. We do not consider it would be normal market practice to demand proof that VAT had been paid, rather than just a return was filed. We put it to Officer Whitehouse at the hearing that if a return had been filed and no payment made one would expect the company to be deregistered: he agreed that it would be normal, but not always done as speedily as might be hoped.

105. Further, the VAT return for the period of September to November 2020 would not have been available to request until at least 7 December 2020. By that point, TCS had been deregistered. Promeridian were notified of this fact on 17 December 2020. Hence we place little weight on Promeridian not having obtained that return as part of their due diligence.

106. We consider the fact that TCS had gross payment status in January 2020 would have given some assurance that it was a compliant company.

107. We also consider that Mr Marian would have had some assurance from his site visits and the fact that TCS was completing work to a satisfactory standard.

108. We therefore do not consider this to be a factor indicating that the Appellants had the requisite knowledge.

Summary as to knowledge

109. In summary, of the ten factors relied on by HMRC, the only ones which we consider to be significant are:

(1) prior contact with Mr Tonica; and

(2) basic errors on TCS invoices, which are suggestive that Mr Tonica had a lax attitude to VAT compliance.

110. In addition to that we have found that Mr Marian was not a reliable witness, for the reasons stated at and around paragraphs [49], [62], [71] and [95] of this Decision.

111. Standing back and looking at the totality of the evidence, whilst these factors may give rise to suspicion, we do not consider that they are sufficient, on balance of probabilities, to show Promeridian knew that the transactions were connected to fraud. Nor do they indicate that the only reasonable explanation for the transactions in which Promeridian was involved was that they were connected with fraud. We do not consider that Promeridian should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion.

112. It follows that we allow the appeal against the *Kittel* Decision. It follows that the appeal against the Company Penalty is also allowed. As noted at the outset, the parties agree that, on the facts of this case, if the appeal against the *Kittel* Decision was allowed the appeal against the *Ablessio* Decision must also be allowed. We therefore allow the appeal on the *Ablessio* Decision.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

113. 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: 07th MARCH 2025