INPUT TAX – MTIC fraud – whether agent's knowledge attributed to company – yes—appeal allowed

FTC/91/2010
[2012] UKUT 18 (TCC)

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

BETWEEN:

THE COMMISSIONERS FOR HER MAJESTY' S REVENUE AND CUSTOMS

Appellants

- and –

GREENER SOLUTIONS LIMITED

Respondent

TRIBUNAL: The Chamber President, the Hon Mr Justice Warren

Sitting in public at the Royal Courts of Justice, Strand, London WC2A 2LL

Christopher Foulkes instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Appellants

Colin Wells instructed by Aegis Tax LLP for the Respondent

Hearing dates 26, 27 September 2011

DECISION

The Appellants' appeal is allowed.

REASONS

Introduction

1. This is an appeal by the Appellants ("**HMRC**") from a decision of the First-tier Tribunal, Judge Avery Jones and T Marsh ("**the Tribunal**"), released on 26 August 2010 ("**the Decision**"). Before the Tribunal, the Respondent ("**GSL**") appealed against a decision of HMRC not to repay something over £176,000 input tax for the period 11/06 on the basis that GSL's transactions in mobile phones were connected to MTIC fraud. The Tribunal allowed the appeal, holding that GSL neither knew nor should have known that a particular transaction was connected with MTIC fraud. This transaction is described in paragraph 5d below and I shall refer to it as "**the Transaction**".

2. There was no issue between the parties before the Tribunal, and there is no issue before me, that the Transaction was connected with fraud. The fraud involved contra-trading by a company called Jag-Tec Ltd; and, as the Tribunal put it, "GLS was the exporter in a "clean chain" which involved Jag-Tec paying output tax on the acquisition of goods in the clean chain in order to disguise the fact of the repayment due in the "dirty chain"".

3. It is common ground before me that the individual who played the major role in relation to the Transaction on the part of GSL, Mr Oliver Murray, had actual knowledge of the connection with fraud. As the Tribunal recorded, it was conceded by GSL that Mr Murray and MBG Associates Limited ("**MBG**"), a company of which he was the sole director, knew that the Transaction was connected to fraud by Jag-Tec and the missing trader in the dirty chain.

4. HMRC argued before the Tribunal that Mr Murray's knowledge should be attributed to GSL in the context of the claim for repayment of input tax,

alternatively, that the directors and/or senior employees of GSL should have known of the connection, so that GSL had the requisite means of knowledge. The Tribunal rejected HMRC's argument. HMRC appeal on the grounds that the Tribunal were wrong to do so: either GSL did know of that connection, alternatively, if it did not actually know, it should have known of that connection. The first issue in this appeal, therefore, is whether Mr Murray's actual knowledge is to be imputed to GSL. If it is, then HMRC's appeal must succeed. If it is not, then the second issue is whether the connection with fraud is something of which GSL should have known.

Mr Murray and the Transaction

5. The Tribunal heard evidence not only about Mr Murray's knowledge of the connection with fraud but also of his involvement in the Transaction on behalf of GSL. It is necessary to put his involvement in context. For the purposes of the first ground of appeal, it is sufficient to note the following which I take from [3] of the Decision:

    a. GSL's business consists of making arrangements with companies like Tesco to collect unwanted mobile phones in their stores for which the customer receives club card points, a charity nominated by Tesco receives a donation and the Appellant gets the phone. The phone is sold to Dubai or Hong Kong where it is ultimately sold on to India, Africa and South East Asia. In addition, GSL purchases phones from retailers (including network operators such as Vodafone) that have been rejected by the customer during the 14 day cooling-off period. These cannot be resold as new and are also exported. GSL also purchases donated second-hand phones from charities. It has an established business with around 12 staff. The Respondents investigated repayment claims in March 2004 and October 2004 before the Transaction and were satisfied that GSL's activities at that time had nothing to do with MTIC fraud. In that connection the officers discussed MTIC fraud with GSL which was aware of Notice 726.

b. GSL was interested in expanding into the new mobile phone market and had been approached by Orange and Motorola. GSL had always refused offers from those companies on the basis that it could not find a buyer but it was still interested in the higher profit margins that were available in the new phone market.

c. The opportunity to participate in the new mobile phones market presented itself when one of the directors of GSL (Mr Erik Mhitarian) introduced Mr Ollie Murray, the sole director of MBG. Mr Mhitarian was the principal financier of GSL and was looking for higher returns for it at a time when the second-hand market was sluggish. Mr Murray was introduced as having a successful company that was experienced in dealing in new mobile phones wholesale but he did not have the capital to build up the business. An informal arrangement was made that GSL would finance a trial transaction as described in detail by the Tribunal. Because the introduction came from Mr Mhitarian, GSL did not check out either Mr Murray, although they met him, or MBG. It relied on Mr Murray's knowledge in entering into the Transaction. In particular it relied on MBG to identify the buyer and seller, conduct due diligence on them and deal with all aspects of the Transaction, keeping GSL informed and ultimately putting forward the Transaction for GSL to sign the final deal. Since GSL had not previously entered into a wholesale transaction involving new phones it relied on MBG's expertise in relation to the Transaction.

d. The Transaction was the purchase from NEX Trading Limited ("NEX") of three types of Nokia phones (1,100 Nokia 8800 at £301.34 per phone, 1,500 Nokia N80 at £227.34, and 1,200 Nokia N91 at £279.34) for £1,007,692 plus VAT and their resale for a total of £1,048,160 (at £313.15, £235.85, and £291.60 per phone respectively) to Complementos de Exportacion Multifuncionales SA ("CEMSA"), a Spanish company, for delivery to a warehouse in Calais. The Transaction proceeded with Mr Murray on behalf of MBG doing all the detailed work in connection with the Transaction and keeping GSL informed of progress and documentation, although he did not show everything to GSL. .

6. Mr Wells, appearing behalf of GSL, says this: Mr Murray was instructed by GSL as a "deal consultant" to introduce a legitimate new mobile telephone deal to GSL. He was not employed as a company official, nor was he a director or employee or agent. He was not a controlling mind of GSL. There was no contract of employment. GSL had no employer control or sanction over Mr Murray. GSL itself kept overall control of the Transaction.

7. HMRC ascribe a rather fuller role to Mr Murray. Mr Foulkes appearing for HMRC says that there was no issue but that Mr Murray had been engaged by GSL to source and conduct the Transaction on its behalf. Although he provided the directors of GSL with some of the relevant documentation in respect of the Transaction, which had to be formally "signed off" by a director, the evidence demonstrated that the real responsibility for the deal lay with Mr Murray. The Tribunal would appear to have accepted that. This follows from the way in which they addressed the law. In considering the attribution of knowledge to a company, we find this at [20] of the Decision:

> "The context in which attribution is relevant is the application of *Kittel* where knowledge is critical to the VAT result. For this reason one would in principle attribute the knowledge of someone, whether an employee or not, dealing with a transaction in which *Kittel* is relevant, to the company engaged in the transaction. If such knowledge were not attributed to the company the directors could close their eyes to the fraud by leaving the transactions to employees."

8. Mr Murray was clearly seen by the Tribunal as "dealing with the transaction": see paragraphs 5(c) and (d) above. That the Tribunal then went on to consider the *Hampshire Land* exception for fraud (which I come to later) indicates that, but for that exception, they would have attributed the knowledge of Mr Murray to GSL. Thus at paragraph 34 of the Decision, the Tribunal identified the issue as being whether the *Hampshire Land* exception applied stating also that Mr Murray "was engaged by GSL to do all acts relating to the transaction short of signing the contracts".

The Law

9. The Tribunal addressed the law in [14] to [33] of the Decision. They first considered *Mobilx v HMRC* [2010] STC 1436. It is worth repeating the explanation given by Moses LJ (with whom the other members of the Court agreed) of the decision of the Court of Justice in *Axel Kittel v Belgium; Belgium v Recolta Recycling SPRL* C-439/04 and C-440/04 [2006] ECR 1-6161 at [43] ("***Kittel***"):

> "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* § 59 and *Kittel* § 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."

The connection does not have to be involvement in the "dirty chain". Involvement in contra-trading means that the participant fails to meet those objective criteria.

10. The meaning of the phrase "knew or should have known" was explained by Moses LJ later in his judgment. The Tribunal set out [50] to [52] of his judgment and his conclusions at [59] and [60]. I do not need to repeat [50] to [52], noting only that Moses LJ considered that that phrase must have been intended by the Court of Justice to have the same meaning as the phrase "knowing or having any means of knowing" which it used in case C-484/03 *Optigen*. A taxpayer who has the means of knowledge of participation in fraudulent evasion of VAT 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 is, however, useful to set out the summary at [59] and [60]:

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

> connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> 60. The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

11. So far as actual knowledge is concerned, the issue is whether the knowledge of Mr Murray is to be attributed to GSL. It has not been suggested that EU law requires attribution of knowledge to a company for the purposes of VAT in a manner different from the attribution for which domestic law provides. This is surely one of those areas where it is for the national court to ascertain how knowledge of an individual is to be attributed to a company. I proceed on that basis.

12. The leading authority in this area is *Meridian Global Funds Management Asia v Securities Commission* [1995] 2 AC 500 ("***Meridian***"). Although a decision of the Privy Council, it has been regularly applied in cases governed by English law. It is necessary to say something about the facts of the case which can, for present purposes, be taken as follows:

> Mr Koo was the chief investment officer of the appellant, an investment management company. Together with the senior portfolio manager, he used funds managed by the appellant to acquire shares in a public issuer. It was within his authority to do this but these activities were unknown to the board or the managing director. Mr Koo was acting improperly in acting as he did. The transactions in which he was involved resulted in a loss to the funds under the appellant's management which had to be made good by its Australian parent company. As a result of these activities, the appellant became, for a short period, a substantial security holder in the public issuer. The appellant failed to give notice as required by section 20(3) of the Securities Amendment Act 1988 of New Zealand. The Securities Commission instituted proceedings in the High Court of New Zealand for failure to comply with section 20.

13. At pp 506B to 507A, Lord Hoffmann explained that it is a necessary part of corporate personality that there should be "rules by which acts are attributed the company. These may be called "the rules of attribution". The company's primary

rules of attribution will generally be found in its constitution. These would include votes on certain matters, for instance where a majority vote of shareholders on the appointment of a board member is deemed to be a decision of the company. Then there are rules of attribution which are not expressly stated in the constitution but are to be implied by company law, for instance the rule that the unanimous decision of all the shareholders in a solvent company about anything within its powers shall be the decision of the company. These primary rules of attribution are built on by using general rules of attribution which are equally available to natural persons, namely the principles of agency.

14. Let me now pick up what Lord Hoffmann had to say about cases where these rules are not enough. He said this, at p507B – F:

> "The company's primary rules of attribution together with the general principles of agency, vicarious liability and so forth are usually sufficient to enable one to determine its rights and obligations. In exceptional cases, however, they do not provide an answer. This will be the case when a rule of law, either expressly or by implication, excludes attribution on the basis of the general principles of agency or vicarious liability. For example, a rule may be stated in language primarily applicable to a natural person and require some act or the state of mind on the part of that person "himself" as opposed to servants or agents. This is generally true of rules of the criminal law, which ordinarily impose liability only for the actus reus and mens rea of the defendant himself. How is such a rule to be applied to a company?
>
> One possibility is that the court may come to the conclusion that the rule was not intended to apply to companies at all; for example, a law which created an offence for which the only penalty was community service. Another possibility is that the court might interpret the law as meaning that it could apply to a company only on the basis of its primary rules of attribution, i.e. if the act giving rise to liability was specifically authorised by a resolution of the board or a unanimous agreement of the shareholders. But there will be many cases in which neither of these solutions is satisfactory; in which the court considers that the law was intended to apply to companies and that, although it excludes ordinary vicarious liability, insistence on the primary rules of attribution would in practice defeat that intention. In such a case, the court must fashion a special rule of attribution for the particular substantive rule. This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was for this purpose intended to count as the act etc. of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy."

15. Lord Hoffmann went on, at pp 507G – 509A, to consider the contrasting cases of *Tesco Supermarkets Ltd v Nattras* [1972] AC 153 and *In re Supply of Ready Mixed Concrete (No. 2)* [1995] 1 A.C. 456. They are interesting illustrations but I do not think that I need to go into them in this decision.

16. What is relevant to refer to, however, is Lord Hoffmann's consideration of *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 and Viscount Haldane's use of the phrase "directing mind and will" of a company. That can be a useful concept in the exercise of attribution of knowledge to a company but it is not always to the point. As Lord Hoffmann put it at p 511C:

> "It will often be the most appropriate description of the person designated by the relevant attribution rule, but it might be better to acknowledge that not every such rule has to be forced into the same formula."

17. Applying that approach to the facts of the case, Lord Hoffmann asked himself What rule should be implied as to the person whose knowledge for this purpose is to count as the knowledge of the company? He answered his own question by saying that it was surely the person who, with the authority of the appellant, acquired the relevant interest (*ie* the securities in the public issuer). Otherwise the policy of the Act would be defeated. Accordingly, the appellant, for the purposes of section 20(4)(e) of the Act, knew that it had become a substantial security holder when that was known to the person who had the authority to do the deal. But:

> "The fact that Koo did the deal for a corrupt purpose and did not give such notice because he did not want his employer to find out cannot in their Lordships' view affect the attribution of knowledge and the consequent duty to notify."

18. It was not, therefore, necessary, as Lord Hoffmann noted, to enquire into whether Mr Koo could have been described in some more general sense as the "directing mind and will" of the appellant. But, wishing to guard against any suggestion that their Lordships were to be taken as saying that whenever a servant of a company has authority to do an act on its behalf, knowledge of that act will for all purposes be attributed to the company, he added this at pp 511H – 512B:

> "It is a question of construction in each case as to whether the particular rule requires that the knowledge that an act has been done, or the state of mind with which it was done, should be attributed to the company. Sometimes, as in *In re Supply of Ready Mixed Concrete (No. 2)* [1995] 1 A.C. 456 and this

> case, it will be appropriate. Likewise in a case in which a company was required to make a return for revenue purposes and the statute made it an offence to make a false return with intent to deceive, the Divisional Court held that the mens rea of the servant authorised to discharge the duty to make the return should be attributed to the company: see *Moore v. I. Bresler Ltd.* [1944] 2 All E.R. 515. On the other hand, the fact that a company's employee is authorised to drive a lorry does not in itself lead to the conclusion that if he kills someone by reckless driving, the company will be guilty of manslaughter. There is no inconsistency. Each is an example of an attribution rule for a particular purpose, tailored as it always must be to the terms and policies of the substantive rule."

19. Lord Hoffmann referred to the question as being one of construction. He is there addressing principally the case where it is a statute which has to be construed. But what he said goes wider than that as can be seen from the last sentence of the paragraph on p 507 ending at letter F ("One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is in a statute) and its contents and policy". The same approach will, I consider, inform the answer to the question Whose act (or knowledge or state of mind) is to count as the act *etc* of the company <u>for the purpose of applying the test in *Kittel* and *Mobilx*</u>?

20. Having reached the *prima facie* conclusion at [20] of the Decision that one would in principle attribute to the company the knowledge of someone, whether an employee or not, dealing with a transaction in which *Kittel* is relevant, the Tribunal went on to consider what they described as an exception, which they referred to as the *Hampshire Land* principle, after *In re Hampshire Land* [1896] 2 Ch. 743. Although that decision has been considered in later authorities, it is necessary to go back to it. It was a case concerning a loan transaction where the same person was company secretary of both the lender and the borrower. In the latter capacity, he knew that the borrowing had not been properly authorised. That knowledge was not attributed to the lender so that the lender could claim in the liquidation of the borrower.

21. The real issue was where it was appropriate to draw the line in deciding whether the knowledge of the common officer of two companies learned in one capacity is to be attributed to the other company. Vaughan Williams J drew the line in this way, at p748:

> "…that the knowledge which has been acquired by the officer of one company will not be imputed to the other company, unless the common officer had some duty imposed upon him to communicate that knowledge to the other company, and had some duty imposed on him by the company which is alleged to be affected by the notice to receive the notice."

22. At p 749, he stated his view that the case before him was not at all like that. It was more like the case of fraud where the knowledge of the officer that he had committed fraud would not have been knowledge of the society of the facts constituting that fraud "because common sense at once leads one to the conclusion that it would be impossible to infer that the duty of either giving or receiving notice, will be fulfilled where the common agent is himself guilty of fraud". The decision was that the same reasoning extended to a breach of duty short of fraud. The Judge declined to hold that the officer's knowledge of his own fraud or breach of duty was the knowledge of the company.

23. Putting that decision into the language of *Meridian*, the question is what attribution to the lender is to be made of the knowledge of its officer that the borrower was exceeding its authorised borrowing limits in the context of a legal principle which would have prevented the lender from proving in the insolvency of the borrower. It is not at all surprising that the knowledge of the common officer was not to be attributed to the lender given the context in which that officer acquired the relevant knowledge *ie* in his capacity as an officer of the borrower. It does not follow from *Hampshire Land* that in no circumstance involving fraud or breach of duty will the knowledge of a common officer be attributed to one or both of the companies of which he is an officer.

24. The *Hampshire Land* principle was applied in *JC Houghton & Co v Nothard Lowe & Wills Ltd* [1928] AC 1, a case referred to in *Stone & Rolls v Moore Stephens* [2009] 1 AC 1391 ("***Stone & Rolls***"). So, in a case where the director who is in breach of duty has an interest adverse to that of the company, knowledge of the breach of duty will not be imputed to the company. As Viscount Sumner said (see at p 19) "It has long been recognised that it would be contrary to justice and common sense to treat the knowledge of such persons as that of their company, as if one were to assume that they would make a clean breast of their delinquency."

25. A similar approach was adopted in *Belmont Finance Corporation Ltd v Williams Furniture Ltd* [1979] 1 Ch 250 although *Hampshire Land* was not cited. In that case, the question was whether the company was debarred from seeking relief in relation to the purchase of its shares in breach of section 54 Companies Act 1948, it being said that it was aware of the fraudulent conspiracy of its directors just because they were directors. Buckley LJ considered that knowledge of the conspiracy could not be imputed to the company. The purpose of the conspiracy was to deprive the company of some of its assets: it was a party at which the conspiracy was aimed and was the victim of it. He referred to the

> "well-recognised exception from the general rule that a principal is affected by notice received by his agent that, if the agent is acting in fraud of his principal and the matter of which he has notice is relevant to the fraud, that knowledge is not to be imputed to the principal."

26. I come to *Stones & Rolls* later in this decision, but before I do so, I want to consider the decision of Dyson J in *McNicholas Construction Ltd v HMRC* [2000] STC 533 ("***McNicholas***").

27. *McNicholas* was in the same territory as the present case in that they both concern VAT. As the Tribunal summarised the case, the site managers of a construction company, McNicholas Construction ("**MC**"), engaged labourers who did not hold certificates entitling them to be paid without deduction of tax. The managers arranged for "sub-contractors" registered for VAT, who held certificates entitling them to pay the labour without deduction of tax, to issue invoices for VAT to MC as if the sub-contractors had actually engaged the labourers, which it was found they had not.

28. Thus, MC was claiming VAT relief as input tax of the amounts of VAT paid to these sub-contractors pursuant to the invoices. If no supplies were in fact being made there could be no obligation on MC to pay the VAT on the invoices (or indeed any amount at all), and no right therefore for MC to claim any input tax in respect of the amounts purportedly paid as VAT.

29. In the light of that analysis, the Tribunal said this at [30] of the Decision:

> "What the fraudulent site mangers set out to do was to assist the labourers in receiving their pay without any tax deduction thus assisting the labourers to defraud the Inland Revenue. No harm or benefit (other than a possible commercial advantage) was intended for MC but the unintended consequence

(although intention to evade VAT was inferred as being foreseeable consequence of its actions) of its entering into the transactions was that MC paid what was ostensibly VAT to the sub-contractors, which, not being VAT on any supply, was not deductible as input tax. The appeal was against an assessment to recover the input tax deducted (there was no penalty assessment). MC claimed that it was the victim of the fraud, and accordingly that the acts of the site mangers should not be attributed to it in determining whether Customs could make an assessment outside the normal time limits (which applies only if there is conduct involving dishonesty within the provisions relating to fraudulent evasion of VAT). Attribution of knowledge had no relevance to whether the assessments were otherwise valid."

30. The VAT Tribunal decided that the site managers' dishonesty was to be attributed to MC for the purposes of the VAT legislation. Like the Tribunal in the present case at [20] of the Decision, the VAT Tribunal decided that the knowledge, acts and omissions of the site managers ought in principle to be attributed to MC. They decided that the *Hampshire Land* principle did not apply since the frauds to which the site agents were parties were not frauds on the true interests of MC; rather, they were committed against the Customs and Excise Commissioners not against MC whose position was "neutral". And that was because the amounts that it had paid purporting to be VAT had been recovered as input tax.

31. Dyson J dismissed MC's appeal. He rejected MC's submission that in determining whether to attribute the acts and knowledge of the site managers to MC, the VAT Tribunal should have applied the "directing mind and will" test. He agreed with the VAT Tribunal that the acts and knowledge of all those employees of a company who have a part to play in the making and receiving of supplies, as well as those involved in its VAT arrangements, are in principle to be attributed to the employing company, in that case for the purposes of sections 60 and 61 VAT Act 1994.

32. Dyson J then went on consider the *Hampshire Land* principle starting at [51] of his judgment. He referred to *Hampshire Land* itself, *JC Houghton & Co v Nothard Lowe & Will Ltd* and to *Belmont Finance Corporation Ltd v Williams Furniture Ltd*. At [55] of his judgment, he held as follows:

"55. In my judgment, the Tribunal correctly concluded that there should be [*no*] attribution in the present case, since MC could not sensibly be regarded as a victim of the fraud. They were right to hold that the fraud was "neutral" from MC's point of view. The circumstances in which the exception to the general rule of attribution will apply are where the person whose acts it is

sought to impute to the company knows or believes that his acts are detrimental to the interests of the company in a material respect. This explains, for example, the reference by Buckley LJ to making "a clean breast of their delinquency". **It follows that, in judging whether a company is to be regarded as the victim of the acts of a person, one should consider the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective**. As the Tribunal pointed out, in Pioneer Concrete the company suffered a large fine for contempt of court on account of the wrongful acts of its managers. The fact that their wrongful acts caused the company to suffer a financial penalty in this way did not prevent the acts and knowledge of the managers from being attributed to it.

56. The Hampshire Land principle or exception is founded in common sense and justice. It is obvious good sense and justice that the act of an employee should not be attributed to the employer company if, in truth, the act is directed at, and harmful to, the interests of the company. In the present case, the fraud was not aimed at MC. It was not intended by the participants in the fraud that the interests of MC should be harmed by their conduct. In judging whether the fraud was in fact harmful to the interests of MC, one should not be too ready to find such harm. In my view, the cash flow point made by Mr Purle comes nowhere near being serious enough to trigger the principle. Looking at the facts of this case from a common sense point of view, there was no VAT fraud or harm to the interests of MC. The Tribunal were entitled to reach this conclusion. It was the correct conclusion to reach." [My emphasis. Note also that the word "no" in the second line of [55] is obviously a mistake. The VAT Tribunal had decided that there was attribution because the company was not the victim of the fraud]

33. The next case I need to mention is the decision of the Court of Appeal in *Bank of India v Morris* [2005] EWCA (Civ) 693; [2005] 2 BCLC 328. In that case, the knowledge of a manager of the Bank of India who was involved in a fraud was imputed to the Bank so as to make it liable for penalties for fraudulent trading since his breach of duty was not aimed at harming the Bank. The Court of Appeal said that the potential liability of the Bank under section 213 Insolvency Act 1986 was irrelevant in deciding whether the Bank was a victim of the manager and whether his knowledge should be attributed to it for the purposes of section 213. Thus in both *McNicholas* and *Bank of India* knowledge was attributed to a company in circumstances where the breach of duty was not aimed at harming the company although it had adverse consequences for the company not intended by the person in breach his duty to the company.

34. The scope of the *Hampshire Land* principle was addressed by the House of Lords in *Stone & Rolls*, a case which was considered at length by the Tribunal. In *Stone & Rolls*, auditors had been sued by the company which was in insolvent

liquidation. The company alleged negligence against the auditors in failing in their audits to have detected fraud against the company on the part of Mr Stojevic who owned, controlled and managed it. The House of Lords held by a majority that since Mr Stojevic was the beneficial owner and directing mind and will of the company who, as its human embodiment, exercised exclusive control over it, the exception to the rule of attribution (that it would be unjust to fix the company with the fraudulent intentions of its directors) did not apply. The result was that the company was to be imputed with awareness of the relevant fraudulent activities (against certain banks) and was primarily liable for them. The auditors were allowed to rely on the principle of *ex turpi cause non oritur actio*. The decision relied on the fact that the company was a "one-man" company so that the *Hampshire Land* principle did not come into play.

35. Although each of the judges considered *Hampshire Land*, they did not speak with one voice about it. Rimer LJ in the Court of Appeal had expressed surprise at the *Hampshire Land* principle being raised in the context of fixing **liability** on a party. He had seen the principle as "primarily concerned not with a company's *liabilities* to others but rather with its claims *against* others". Lord Walker did not agree with that view, seeing no reason in principle why it should be limited to such claims. Lord Brown's explanation of the rationale of the principle is really consistent only with a rejection of Rimer LJ's view. But Lord Mance agreed with the Court of Appeal on this point.

36. Lord Walker found it difficult (see [154] of his speech in *Stone & Rolls*) to understand why, as a matter of fact, the fraud was "neutral" from the point of view of MC, but drew attention to the importance of the words which I have highlighted and appears to accept them as a correct approach. On that basis, MC was not, as the Tribunal put it at [31] of the Decision, the victim of any fraud **aimed against it** and the *Hampshire Land* principle (assuming it was capable of applying to a claim against the company) did not prevent attribution of the fraudster's conduct to MC to enable the making of assessments outside the normal time limits.

37. A company, although not the primary target of a fraud, might be a secondary victim. In that context, Lord Walker had something to say at [173] of his speech,

going on to summarise in [174] the ground of his decision (these passages were cited by the Tribunal):

> "173. …There is in my opinion a clearer and firmer basis on which to determine what (if any) significance to give to the notion of a company being the secondary victim of the fraud (aimed at a third party) of one or more of its directors. It is necessary to keep well in mind why the law makes an exception (the adverse interest rule) for a company which is a primary victim (like the *Belmont* company, which was manipulated into buying Maximum at a gross overvaluation). The company is not fixed with its directors' fraudulent intentions because that would be unjust to its innocent participators (honest directors who were deceived, and shareholders who were cheated); the guilty are presumed not to pass on their guilty knowledge to the innocent.
>
> 174. I would therefore limit my ground of decision in this appeal to the proposition that one or more individuals who for fraudulent purposes run a one-man company…..cannot obtain an advantage by claiming that the company is not a fraudster, but a secondary victim. *McNicholas* and *Bank of India* may be best analysed as depending on a special rule of attribution required by the scheme of the legislation relating to VAT or fraudulent trading (as the case may be). It is not necessary to the disposal of this appeal, or prudent, to address every situation that may be described as involving a secondary victim."

38. The Tribunal, after their own review of those authorities, including citation of much of what I have cited above, concluded, at [33] of the Decision, as follows:

> "The principle we derive from these authorities is that the *Hampshire Land* principle is of general application and applies to prevent the knowledge of the agent in breach of his duty to the company being attributed to a company where the company is a victim of his fraud. In determining whether there is a fraud against the company "one should consider the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective." And "In judging whether the fraud was in fact harmful to the interests of MC, one should not be too ready to find such harm.""

39. HMRC do not challenge that statement of the relevant principles. I agree with it and only add that the decisions in *McNicholas* and *Bank of India* remain good law. Only Lords Walker and Mance mentioned them, the latter finding them of no assistance in the case before him in resolving any question of attribution of knowledge. And Lord Walker did not cast any doubt on the decision whilst suggesting, it is true, an alternative analysis. What is interesting to note, however, is that if such alternative analysis is correct, the special rule of attribution would appear to trump the *Hampshire Land* principle if it would otherwise apply (and thus neatly arrive at the same conclusion as Rimer LJ reached at [71] of his judgment). But care must be taken with that analysis even if it is correct.

McNicholas was concerned with a statutory provision. The attribution in the present case depends on the content and context of *Kittel* and *Mobilx*. It is not necessarily the case that the attribution of knowledge will be the same in respect of the statutory provision and in respect of the *Kittel/Mobilx* test.

40. Returning to the Tribunal's statement of the relevant principles, what HMRC do object to is the application of those principles to the facts. As to that, this is what the Tribunal said in [34] and [35] of the Decision:

> "34. As set out in paragraph 20 we are concerned with *Kittel* for which in principle Mr Murray's knowledge should be attributed to the Appellant. The issue is therefore whether the *Hampshire Land* exception applies which depends on whether on the facts the Appellant is a victim of Mr Murray's fraud. We consider that it is. Mr Murray was engaged by the Appellant to do all acts relating to the Transaction short of signing the contracts. He owed a duty to the Appellant to enter into a genuine commercial transaction. Instead he presented to the Appellant a transaction that he knew was connected to a fraud on HMRC with the result that (if his knowledge were attributed to it) no input tax was recoverable by the Appellant, thus involving the Appellant in a considerable loss because, in the words of the ECJ in *Kittel* at [57], the Appellant "aids the perpetrators of the fraud and becomes their accomplice." If the Appellant had known of the connection with fraud they would not have entered into the Transaction. Mr Murray knew that unless the Appellant entered into the Transaction, he would not benefit from a share of profits from a transaction which he knew was connected to fraud. This result was "the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective" because the effect of the Transaction cannot be judged without taking his knowledge into account. Naturally he hoped that the connection with fraud would not be discovered because otherwise there would be no profit to share, but the same would be true if he were stealing from the Appellant. That was a fraud by Mr Murray against the Appellant in a real sense. In our view this makes the *Hampshire Land* principle applicable.
>
> 35. Standing back and regarding the *Hampshire Land* principle as one of common sense, it seems right that where the recovery of input tax paid by it to NEX depends on the state of the Appellant's knowledge, the knowledge of Mr Murray who was trying to benefit by persuading the Appellant to enter into a transaction that he knew was connected with fraud, should not be attributed to it."

Attribution of Mr Murray's knowledge to GSL on the facts

41. In my judgment, on the facts as found by the Tribunal and applying the (correct) principles identified by them, it was not open to them to reach the conclusion which they did. In doing so, they failed, in my view, to apply their own earlier

conclusion that, in judging whether a company is to be regarded as the victim of the acts of a person, one should consider the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective.

42. Thus in *McNicholas*, it was right to look at the effect of the acts of the fraudsters which was to leave MC in a neutral position since it obtained repayment of input tax paid by it to the bogus sub-contractors. The fact that the Commissioners would be able to recover those repayments if MC was to be treated as having knowledge of the fraud did not mean that the fraud was directed at MC so as to bring the *Hampshire Land* principle into play. Similarly, in *Bank of India*, the manager's acts were not targeted at the Bank. The potential liability of the Bank under section 213 Insolvency Act 1986 was, according to the Court of Appeal, irrelevant in deciding whether it was a victim of the manager and whether his knowledge should be attributed to it for the purposes of section 213. Both of these decisions remain good law and nothing which was said in *Stone & Rolls* can be taken as implicit criticism of the actual decisions. Indeed, in explaining the decisions in the way which he did in [174] of his speech, Lord Walker recognised the correctness of the decisions, preferring to analyse them as depending on special rules of attribution. Even accepting that as the correct analysis, it remains the case that the *Hampshire Land* principle was not applicable on the facts of the cases in the contexts of the statutory provisions concerned.

43. In my judgment, the decision of the Tribunal in the present case cannot stand with the decision in *McNicholas*, a decision followed by the Court of Appeal in *Bank of India* and implicitly approved, as a decision, by Lord Walker in *Stone & Rolls*. In my judgment, given the findings of fact concerning Mr Murray's role in the Transaction and the statement of principle in [20] of the Decision, his knowledge of the fraud is to be attributed to GSL and the *Hampshire Land* principle is not engaged since the fraud was not aimed GSL.

44. In [34] of the Decision, the Tribunal sought to apply the law which they had discussed. The important passage is this:

> "….. [Mr Murray] presented to the Appellant a transaction that he knew was connected to a fraud on HMRC with the result that (if his knowledge were attributed to it) no input tax was recoverable by the Appellant, thus involving

> the Appellant in a considerable loss because, in the words of the ECJ in *Kittel* at [57], the Appellant "aids the perpetrators of the fraud and becomes their accomplice." If the Appellant had known of the connection with fraud they would not have entered into the Transaction. Mr Murray knew that unless the Appellant entered into the Transaction, he would not benefit from a share of profits from a transaction which he knew was connected to fraud. This result was "the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective" because the effect of the Transaction cannot be judged without taking his knowledge into account."

45. It is not entirely clear what "this result" was intended to refer to but to have any impact on the decision it must be taken as a reference to "involving the Appellant in a considerable loss". The Tribunal was, in essence, saying that if Mr Murray's acts and knowledge were to be imputed to GSL, the effect would be to give rise to a detriment to GSL (since with such knowledge imputed as a result of *Kittel*, GSL had no right to deduct input tax). I agree with Mr Foulkes that such reasoning is flawed and begs the question since, in any case where a company seeks to invoke the *Hampshire Land* principle, it does so because, otherwise, it would suffer a detriment. Mr Murray intended that the connection of the Transaction with fraud would not be discovered since, if it were, he would receive nothing. The only victim of the fraud was intended to be the fisc: if his fraud succeeded, both he and GSL would profit. In contrast, it would only be if Mr Murray's acts proved ineffective that would GSL be deprived of input tax.

46. In *Bank of India*, the potential liability of the Bank under section 213 Insolvency Act 1986 was irrelevant in deciding whether the Bank was a victim of the manager and whether his knowledge should be attributed to it <u>for the purposes of section 213</u>. Similarly, in my view, the potential risk to GLS of a refusal by HMRC to repay purported input tax on the basis of *Kittel* and *Mobilx* is irrelevant in deciding whether GLS was a victim of Mr Murray and whether his knowledge should be attributed to if <u>for the purposes of the *Kittel* principle</u>.

47. I agree also with Mr Foulkes' observations about the context of the substantive rule which gives rise to the issue: it is the objective of combating fraud within the context of the VAT legislation. A parallel objective was to be found in *Bank of India* which led the Court of Appeal, in agreement with Patten J at first instance, to conclude that the application of section 213 required a special rule of attribution in order to make the policy effective. The purpose, or at least a major purpose, of

the *Kittel* principle is to combat fraud. The Tribunal's decision would make a serious in-road into that principle: in cases where there were innocent shareholders or directors who had been deceived by a fraudulent employee or director, the company might be able to escape liability notwithstanding that it was able to profit considerably from the transactions conducted on its behalf.

48. Given that conclusion, it is not necessary to resolve the issue which Rimer LJ (in his judgment in the Court of Appeal) and Lord Walker saw differently, namely whether the *Hampshire Land* principle has any scope for application in a case concerned with a company's *liabilities* rather than its *claims* against others: see [145] of Lord Walker's speech.

Whether GSL "ought to have known" that the Transaction was connected with fraud

49. That is enough to dispose of this appeal. In case this matter goes further I should, however, say something about the alternative limb of the appeal, namely that the Tribunal made errors in respect of various categories of evidence which led them to a conclusion which no reasonable tribunal could property have reached in relation to the issue in question. That issue was the application of the relevant test namely whether HMRC had established that the reasonable trader in the position of GSL should have known that the only reasonable explanation for the circumstances in which the Transaction took place was that it was connected with fraudulent evasion of VAT.

50. In his skeleton argument, Mr Foulkes complains that, having identified a number of factors relied upon by HMRC under the "means of knowledge" limb, the Tribunal then gave alternative explanations for many of these. Some of these, he says, were not advanced on behalf of GSL during the hearing. Whilst the Tribunal's function was to assess the evidence before them, and to come to their own conclusion, Mr Foulkes submits that, where the Tribunal anticipated alternative lines of argument that were not raised by either party, it ought properly to have identified those arguments to the parties in order to allow them to make appropriate submissions.

51. Those factors were addressed in [38] of the Decision. In some cases, the Tribunal put forward explanations which would negative fraud. Mr Foulkes criticises the Tribunal who, he says, gave no indication as to the relative merits of the competing arguments that it identified. He identifies in his skeleton argument the various ways in which he says that the Tribunal fell into error. Although at [39] of the Decision, the Tribunal correctly observed that the evidence should be viewed in its totality in assessing whether the relevant legal test is satisfied, they then simply concluded that HMRC had failed to discharge the burden, giving no reasons as to how they reached that conclusion.

52. Accordingly, Mr Foulkes submits that the totality of the alleged errors made by the Tribunal in respect of the evidence led them to a conclusion that no reasonable Tribunal could have reached. He says that their failure to give any, or any adequate, reasons lends further support to this conclusion. It is the cumulative effect of the errors and a consideration of the evidence as a whole which gives rise to the challenge to the Tribunal's conclusion under the second limb.

53. Mr Foulkes then sets out, in his skeleton argument, submissions in relation to Grounds 2 to 19 of the Appellant's notice. I take them in turn.

54. **Ground 2: conclusions on the inherent probability of fraud**. At [37] of the Decision, the Tribunal started their consideration of the "ought to have known" limb by looking at the law on the standard of proof. The Tribunal noted (something which could not have been known at the time of the Transaction from September to November 2006) that perceptions about the inherent probability of fraud were rapidly changing, stating that the evidence did not give any measure of the inherent probability over the period of the Transaction. They did recognise, however, that this period fell after the judgment in *Kittel* and after the announcement of the reverse charge (to combat MTIC fraud) in July 2006 intended to apply from October 2006 adding that the evidence "….points to the fact that circumstances were changing so rapidly that nobody was likely to have an up-to-date view on the inherent probability of fraud but by the time of the Transaction this must have been greatly reduced".

55. There was, however, some evidence before the Tribunal about the probability of fraud in this market at the time. Mr Foulkes submits that the evidence established the following:

    a. that HMRC had visited GSL and warned its officers about the prevalence of MTIC fraud in the new mobile phone wholesale sector in particular;

    b. that its officers were aware of VAT Notice 726, which warns again about MTIC fraud and the steps that are necessary to guard against it;

    c. that by September 2006 it was well-known in the trade, (and to the GSL) that a large number of new mobile phone wholesalers had had VAT repayment claims delayed pending verification, given the prevalence of fraud in the sector;

    d. that by September 2006 it was well-known in the trade that the UK Government had announced an intention to introduce the reverse charge in this trade sector in October 2006 (it was in fact not introduced until later in 2007) in order to combat the problem of MTIC fraud, which was particularly prevalent in this sector;

    e. that the problem of MTIC fraud was regularly reported in the UK press;

    f. that following the introduction of the reverse charge in 2007 the number of traders registering under the scheme in order to be able to trade in this sector was a tiny proportion of the number of traders previously operating.

56. There was certainly evidence before the Tribunal in support of those matters and some of it was referred to by them in the Decision. The Tribunal did not, unfortunately, make findings in relation to all of them. Although what the Tribunal referred to as the "inherent probability" of fraud was not known at the time, what I think was clear were the matters referred to in paragraphs c and d of the preceding paragraph and that, as a matter of fact, paragraph f is correct. For my part, I am not at all clear what the relevance of the "inherent probability" actually is. The important point is not the actual level of probability of MTIC fraud in relation to trade in mobile phones but is that fraud was a significant

problem, whether it was present in 1% or 80% of such trades. Once it was appreciated by reasonable traders that they needed to be aware of the risk of involvement in fraudulent trade, an objective assessment had to be made, on the facts of a particular case, whether a reasonable trader in the position of the actual trader would have realised that there was no reasonable explanation, other than fraud, for aspects of the transactions in question. On the evidence before the Tribunal, it was clear that a reasonable trader in the position of GSL would have known that MTIC fraud was a significant problem in the sector albeit that the "inherent probability" was not known.

57. In any case, Mr Foulkes submits that there was no evidence before the Tribunal that the "inherent probability" was rapidly changing as the Tribunal stated. I know of no such evidence and Mr Wells has not taken me to any. As Mr Foulkes points out, what the evidence did demonstrate was a downturn in the number of transactions, but there was nothing to show what proportion of the remaining trades were connected to fraud. He goes on to say this:

> "The Tribunal's conclusion that by the time of the relevant transaction the probability of fraud "must have been greatly reduced" is not supported by the evidence and was not something raised by either the Company or the Tribunal during the hearing. This conclusion is dealt with at the outset of the Tribunal's decision on means of knowledge, and is clearly something that it considered to be of great significance. It clearly affected the Tribunal's assessment of the factors relied upon by the Commissioners. Yet the only correct conclusion to reach on this topic is that at the time of the relevant transaction, the reasonable trader would be very much alive to the prevalence of MTIC fraud and consequently alert to indications that a given feature was inconsistent with a transaction in a legitimate deal chain."

58. For my part, I would have thought it almost self-evident that the proportion of fraudulent transactions had reduced. The reverse charge was intended precisely to eliminate the possibility of a VAT loss through MTIC fraud and the announcement of its imminent introduction must surely account for a large part of the reduction in the number of trades. Although the announcement of the reverse charge might have had some impact on the number of legitimate trades, I would expect the impact on fraudulent trades to have been far greater, with the result that the proportion of fraudulent trades to legitimate trades would have reduced. I think Mr Foulkes criticism therefore goes too far. But that does not detract from his identification of the "only correct conclusion" with which I agree.

59. It does not follow from any of that that the Tribunal in fact arrived at an incorrect assessment of the factors on which reliance was placed by HMRC to show that GSL ought to have known of the fraud. But it does raise concerns about the approach of the Tribunal. Those factors are dealt with, so far as HMRC say that the Tribunal erred, in Grounds 3 to 19 to which I now turn.

60. **Ground 3: conclusions as to relevance of Mr Murray's willingness to disclose information to GSL**. HMRC relied on Mr Murray's apparent willingness to give information to about suppliers and customers without any guarantee of further working with GSL: it had had offers from legitimate suppliers but had been unable to find customers. Mr Murray had divulged this information to GSL when GSL had struggled to identify customers for itself. Why, it might be asked, would Mr Murray be willing to give out this valuable information without, at the least, a commitment on the part of GSL to enter into further transactions? There was contradictory evidence from Mr Bruce-Payne and Miss Sexton (both of GSL) about whether it was anticipated that Mr Murray would continue to conduct business transactions for GSL as is reflected in [38(2)] of the Decision. Mr Foulkes says that the Tribunal gave no recognition to the submission made to them that, had Mr Murray been able to expand MBG, he would have given up this information to a competitor for the sake of one deal; they clearly did not expressly deal with that submission. The failure to do so is a, but only one, factor which must be taken into account in deciding whether, on the totality of the evidence, the Tribunal reached a conclusion which was not properly open to it.

61. The Tribunal found as a fact that GLS would not have considered itself free to use that information in the absence of a continuing relationship with Mr Murray and would not have considered that it had the expertise to enter into further deals in new phones. That too must be taken into account as a factor.

62. **Ground 4: conclusion about relevance of the recent import of goods**. The Tribunal agreed with HMRC that the recent import followed by export was certainly not to be expected in the grey market. They then went on to say that a possible and quite innocent explanation was that a proposed deal in the UK may have failed so the goods were being exported again. Mr Foulkes says that this was not an argument advanced by GSL which I am sure is correct otherwise Mr Wells

would have shown me where in the transcript the points had been made by him. He goes on, in his skeleton argument, to say this:

> "[That argument] was in part suggested by the Tribunal during submissions, to the extent that it suggested that there may be a sudden dearth of a given handset in France once the goods had arrived in the UK. The Commissioners submit that both versions of the scenario advanced by the Tribunal are so inherently unlikely as to have little impact upon the point being advanced. Mr Fletcher's evidence was that legitimate grey market transactions involved short deal chains with each participant playing a different role and thereby adding value. A UK importer would be expected to have identified its onward market, which would be very likely to involve breaking down the consignment for onward sale to smaller wholesalers or retailers. Even in the unlikely event that its onward customers reneged on the deal, it would be surprising that the best opportunity would involve the goods being exported again, given the additional cost involved in so doing."

63. That is a powerful submission which leads me to think that the Tribunal may well have placed far too much weight on their alternative possibilities than was warranted. But even if there was, in fact, an innocent explanation along the lines suggested by the Tribunal, there was no evidence whatsoever before the Tribunal that this is what Mr Bruce-Payne or Miss Sexton actually believed, let alone that they had made any enquiry of Mr Murray (or anyone else) and had been given such an explanation. As the Tribunal itself stated, the import/export was not to be expected in the grey market so that a reasonable trader would surely be expected to satisfy himself that there was some reasonable explanation without assuming it.

64. **Ground 5: conclusion about existence of written terms and conditions**. The absence of written terms and conditions would, ordinarily, be a factor which should ring an alarm bell. The Tribunal, however, seem to have attached considerable weight to the fact that GSL conducted its business with Tesco without written terms. It is not clear that that is correct since, as the Tribunal said, there were some terms on the reverse of Tesco's invoices, going on to note that there was no evidence whether the invoice prepared by GSL for the Transaction had any terms on the back. In any case, it does seem to me that only the slightest, if any, weight can be attached to an absence of written terms with Tesco. Tesco was clearly a company which it was reasonable to assume would conduct only legitimate trade and whilst it may be reasonable to assume that deals with such a

trading partner are legitimate, such an assumption may be unwarranted in relation to a trading partner of an entirely different nature.

65. As to written terms and conditions, Mr Foulkes notes that the Transaction was sourced and arranged by Mr Murray. Ms Sexton stated that GSL had produced the invoice, which was identified as the only possible source of any terms and conditions. He says that it was clear that neither the supplier nor the customer, through Mr Murray or otherwise, or Mr Murray himself as GSL's representative, had raised any issue as to whether and if so which terms and conditions should be included on the invoice. There was no evidence to the contrary so that proposition may be taken to be correct. I agree with Mr Foulkes when he says that, in the context of such a high value transaction, this was an indication (I would not go so far as to say that it was a clear indication in the sense of being virtually irrebuttable) that the Transaction was not legitimate. To the extent that the Tribunal dealt with the point, it was dismissed in the short statement that there was no evidence as to whether the invoice had any terms or conditions. In my view, in the absence of any evidence, it was not open to the Tribunal to assume, if they did, that there were any such terms let alone what they might have been. Accordingly, HMRC's point was not properly addressed and what the Tribunal actually said was not a "contrary argument" at all.

66. **Ground 6: conclusion as to relevance of location of customer**. The Tribunal recorded that goods were sent to a warehouse in Calais for a Spanish customer who was not a retailer, a fact on which HMRC relied as being unusual and which would have caused a reasonable trader some concern. The Tribunal recorded the contrary argument as being that there are provisions in the VAT Directive for triangular trading in which goods are delivered to a different country to that of the buyer (referring to the recent decision of the Court of Justice *Facet BV* Cases C-536/08 and C-539/08 [2010] STC 1701) "so such trading cannot be unusual in general".

67. HMRC's first complaint is that this point was not raised in argument and no opportunity was given to make submissions about it. Mr Foulkes now makes these submissions to quote from his skeleton argument:

> "Although the provisions within the VAT Directives allow for triangular trading, the location of the delivery in a country other than that of the customer gives rise to the inference that the goods were intended for onward wholesale supply rather than distribution to a the retail market. This is of significance given the nature of the legitimate grey market as described by Mr Fletcher. The evidence of the Company's two witnesses was again contradictory. One apparently understood that the goods were to be trucked to Spain for onward sale to retailers. The other "got the impression" that the goods were to be sold onto another broker, or to Asia or Hong Kong. The fact that each was given to understand different things is itself of significance. Neither understood the position to be that which resembled a typical grey market transaction."

68. Mr Foulkes adds that the Tribunal said nothing about trading in mobile phones in particular and did not consider whether what they saw as a usual way of trading generally was usual in the context of mobile phone trading. Quite apart from all of that, the Tribunal failed to consider a submission which was made about these customers, namely that GSL was not purchasing from an authorised distributor or manufacturer. It does seem to me that the Tribunal's reliance on its contrary argument on this aspect may well be misplaced.

69. **Ground 7: conclusion about the significance of more experienced trading partners' failure to identify better profit margins**. HMRC had relied on the fact that an established trader, NEX, had been unable to find customers and another established trader, CEMSA, had been unable to find suppliers where as GSL (through MBG) was able to do so. NEX, it is to be noted, was the "buffer" from which GSL had acquired the phones involved in the Transaction. The Tribunal identified a contrary argument as being that NEX may not have been able to finance the VAT and so was willing to give someone else part of the profit on the deal that it could have made itself. This explanation was touched on by Mr Bruce-Payne but it was put to him in cross-examination that this was inconsistent with the apparent turnover of the supplier. The Tribunal did not address this issue. Mr Wells says that the Tribunal heard and relied on the evidence of Mr Bruce-Payne on this point and that HMRC called no evidence to contradict that evidence. But Mr Bruce-Payne himself said that it was speculation. There was simply no proper evidence on this point at all and the "contrary argument" appears to be without foundation other than as a matter of speculation.

70. **Ground 8: error in respect of Mr Murray's disclosure of profit margins**. HMRC relied on what Mr Murray had told GSL, namely that he had negotiated a lower price from NEX to enable GSL to retain its margin. The Tribunal held that this was not true and was said by Mr Murray to give the impression that he was doing a good job, but it was reasonable for GSL to believe it. The Tribunal stated, in relation to HMRC's argument, that there was no evidence that Mr Murray had said that he had disclosed the amount of the margin to NEX. Mr Foulkes says that that is wrong and that there was such evidence. He is correct about that, as can be seen in Mr Stokes' evidence (see paragraphs 120-121 of his first witness statement) and from the transcript of the beginning of Day 4 of the hearing. HMRC maintain that this would have been of concern to the reasonable trader but the Tribunal did not properly address the concern because of their error in relation to the evidence. Mr Wells submits that GSL were, through Mr Murray, able to negotiate a commercially advantageous price: no reasonable trader would be concerned to pay a lower price. That submission, it seems to me, is beside the point. Of course a trader in a genuine transaction will not be concerned to pay a lower price but that tells us nothing about whether the actual negotiation of a lower price in the circumstances in which it is said to have take place was a factor which should have put GSL (as a reasonable trader) on notice of possible impropriety. It appears to me, therefore, that the Tribunal did not give adequate consideration to the submission made under this head.

71. **Ground 9: apparent error in respect of relevance of absence of authorised distributor**. HMRC relied on the fact that GSL had access to authorised dealers such as Orange and Motorola and thus had ready access to the legitimate grey market. Instead, GSL made a deal with NEX, a non-authorised distributor. Miss Sexton said that this aspect had not occurred to her at the time. GSL says that it had no experience and no customers in this market and so declined business with Orange and Motorola. But that does not explain why Mr Murray, who was apparently able to introduce customers, did not himself arrange for supplies to be acquired from Orange and Motorola. HMRC contend that the fact that Mr Murray showed no interest in acquisition from these legitimate suppliers would be of real concern to a reasonable trader endeavouring to pursue a legitimate trade. Curiously, having said that the point did not occur to Miss Sexton, the Tribunal

said no more about it or about what a reasonable trader might have thought. It does appear that the Tribunal failed to attach any weight to this important point. Mr Wells simply submits that the uncontested evidence which he identifies is a plausible commercial explanation. In that context, he relies on [3(2)] of the Decision. This refers to GSL's interest in expanding into the new mobile phone market and approaches by Orange and Motorola; GSL had always refused such offers because they could not find a buyer. That is all very well, but it does not meet the points made by Mr Foulkes which I have addressed earlier in this paragraph.

72. **Ground 10: relevance of prevalence of UK/Irish nationals running EU trading partners**. The Tribunal recorded that CEMSA's trade reference was a Latvian company run by a Mr Gallagher. According to the Tribunal, Mr Bruce-Payne took up the reference on the phone and was satisfied, although he did not keep a record of the conversation. As to CEMSA (the customer acquiring the phones from GSL under the Transaction), the Tribunal noted that this Spanish company was run by a Mr Russell and had an Isle of Man bank account. The Tribunal explain the contrary argument as being that Mr Russell was stated to have 30 years import and export experience and had been a founder member of a large telecommunications company in Spain selling his share in 1983, factors which would not arouse suspicion. Mr Foulkes observes that there was no evidence about Mr Russell's 30 years experience which was based on mere assertion (in other words, I infer that GSL would have had no evidence to justify a belief that Mr Russell had that experience). HMRC had maintained that the fact that both the Spanish customer and its Latvian trade reference were run by UK/Irish nationals was another factor that the reasonable trader would wish to weigh in the balance when assessing whether its transaction was legitimate. Mr Bruce-Payne was told by Mr Murray to take up the reference and had spoken to someone in Latvia but could not remember what the discussion had entailed or what questions he had asked; he did not take a note of the conversation. He could not remember whether he had taken up other references. Mr Foulkes submits that Mr Bruce-Payne's conduct was far removed from that of the reasonable trader and suggests that the Tribunal's observation that Mr Bruce-Payne was "satisfied" by the phone call is no answer to HMRC's point. Again, the question is not whether

Mr Bruce-Payne was satisfied, but whether a reasonable trader would have been. That question has to be judged in the context of MTIC fraud with companies outside the UK run by English or Irish individuals. I therefore consider that Mr Foulkes is right in his criticism of the Tribunal's approach.

73. Mr Wells says that traders are entitled to make trade with other EU companies because of the single market; he says that HMRC failed to adduce any evidence that CEMSA were anything other than a legitimate trading company; and he says that the Tribunal accepted Mr Bruce-Payne's evidence on this point. The first of those propositions is, of course, true but does not, it seems to me, impact on this Ground of appeal. The second proposition is at odds with the thrust of the Decision; the Tribunal referred to concerns about CEMSA. As to Mr Bruce-Payne's evidence on this point, that evidence, so far as relevant, is summarised in the preceding paragraph. Mr Wells' submissions do not persuade me that Mr Foulkes is incorrect in his submissions.

74. **Ground 11: relevance of out-of-date Veracis report**. The Tribunal had recorded at [4] of the Decision that Mr Murray provided GSL with a Veracis Limited report dated 2 December 2005 (much earlier than the Transaction, indicating that it had been obtained by MBG in relation to an earlier transaction although there was no evidence of a transaction involving MBG at the time) which said that its business was sales in the grey market comprising 70% computer central processing units and 30% notebook computers. Turnover was said to be around £500K per month and had working capital of £150K. The trade description was "other computer related activities" without any mention of phones (from which it is reasonable, I think, to infer that NEX was not in the phone market at the time of the Veracis report). The Tribunal noted the there was a large difference between the turnover at the time of the Veracis report (£500K per month) and at the time of the Transaction (£8m per month). But they went on to say: "On the other hand, the Appellant met Mr Williams [a director of NEX] and understood that he was then dealing in phones". Mr Foulkes submits, and I agree, that the inadequacies of the Veracis report (this is not a criticism of the report but of reliance on it 10 months later) are not met simply by a meeting with a director of NEX. The Tribunal did not, in any case, expressly consider HMRC's reliance on the fact that the goods being traded by NEX, namely mobile phones, were

commonly used in MTIC frauds nor HMRC's submissions to the effect that the age of the Veracis report (which was provided by Mr Murray) was of itself another cause for concern. Mr Wells submits that the Tribunal could rely on Mr Bruce-Payne's evidence that his face-to-face meeting with Mr Williams was preferred to the Veracis report. It may well be preferred but that does not make it adequate. Given the lack of detail about what was discussed or what was shown to Mr Bruce-Payne, I do not consider that Mr Wells' submission meets Mr Foulkes' criticisms.

75. **Ground 12: relevance of unrealistic turnovers**. HMRC had relied on the fact that both NEX and CEMSA had very large turnovers but very few employees. The Tribunal described the contrary argument as being that "both companies appeared to be substantial businesses". Mr Foulkes submits this so-called contrary argument does not address the point at all. Miss Sexton herself accepted the significance of turnover in relation to CEMSA but said that it did not strike her at the time. I agree with Mr Foulkes' criticism. The question is the impact it would have had on the reasonable trader, a matter which the Tribunal did not expressly address. Mr Wells says that the Tribunal's point is valid, but I disagree.

76. **Ground 13: conclusion as to credit report information**. GSL had been provided with a report from Dunn & Bradstreet in relation to CEMSA. This was dated 21 July 2006. The Tribunal noted the following features in the report: (a) the large increase in turnover since the 31 December 2004 accounts from Euros 9.8m to estimated Euros 660m and (b) the low credit rating of Euros 6,611, which they said might be accounted for by the current liabilities exceeding current assets. HMRC relied on those features, among others, in submitting that a reasonable trader would have had concerns. The Tribunal's contrary argument was that the report did contain fairly full accounts for 2004 which showed a loss and an excess of liabilities over current assets and said that, in any case, GSL was not giving CEMSA any credit.

77. Mr Foulkes submits that the Tribunal have missed the point. The reasonable trader would obtain independent financial information in respect of trading partners, a proposition which I do not understand to be challenged by GSL. Mr Wells says that the weight to be given to a Dunn & Bradstreet report was

diminished since GSL were not giving credit to CEMSA. But Mr Foulkes submits that the fact that the accounts for 2004 showed a loss does not answer the concern that the reasonable trader would have to discover whether the company was financially capable of conducting such high value transactions legitimately. This, he says, is of clear significance whether or not that company was in fact extending credit to GSL. It was not addressed by the Tribunal. I agree with Mr Foulkes' criticisms.

78. **Ground 14: relevance of both trading partners holding FCIB accounts**. The Tribunal noted that both NEX and CEMSA had accounts with FCIB. HMRC had relied on this fact since it was, by the time of the Transaction, widely appreciated that FCIB was routinely used by those engaged in MTIC fraud. It appeared that Mr Bruce-Payne knew of concerns about the bank when GSL became involved in the Transaction (see Transcript Day 3 p 182 lines 6 and 7) although he may not have know until later that the Dutch authorities had closed the bank down. GSL were provided with banking details by NEX and CEMSA which made clear that both had accounts with FCIB (whether or not they were used for the Transaction). Miss Sexton appeared not to have noticed the coincidence that both companies held accounts with a bank she had not heard of. Mr Bruce-Payne said that he knew of the concerns surrounding FCIB but that he did not see the relevant documentation which had been sent to GSL before the Transaction was carried out, although Miss Sexton had said that it was available in the office. Mr Foulkes submits that the Tribunal ignored this evidence when it stated that there was nothing to alert GSL to the fact that each company held an account with FCIB. That submission seems to be correct. A reasonable trader in mobile phones in the position of GSL at the time of the Transaction would have known of the concerns surrounding FCIB and would have to take this into account in assessing whether the person with which he was proposing to deal was a legitimate trader or not. It cannot, of course, be said that because a trader banked with FCIB that his activities were necessarily fraudulent, but someone proposing to trade with a person holding an account with that bank ought to take especial care. Mr Wells relies on the fact that GSL did not bank with FCIB nor did it pay any money into an FCIB account. That is true, but it does not meet the point on which HMRC rely.

79. HMRC's grounds of appeal do not include a **Ground 15**.

80. **Ground 16: relevance of Mr Murray's failure to meet CEMSA**. As the Tribunal recorded, neither Mr Murray nor any officer of GSL met CEMSA. HMRC relied on that factor as one which ought to have raised the concerns of GSL. The contrary argument expressed by the Tribunal was that the author of the Veracis report did do so, including in the report photographs of its offices and figures showing that it was of significant size. However, Mr Foulkes submits that Mr Bruce-Payne stressed the importance of personally meeting those with whom it was intended to do business but did not meet anyone from CEMSA. Mr Bruce-Payne said that that was Mr Murray's job but he did not check whether Mr Murray had in fact met with CEMSA (he had not). Mr Foulkes says that in this context the failure to meet was of particular note and complains that Tribunal made no reference to it. In any case, I would add, the photographs and figures were not up-to-date. It was, in my view, a factor which should have been brought into the balance but it does not appear that the Tribunal did so.

81. **Ground 17: relevance of no visit to 1st Freight**. 1st Freight was the operator of the warehouse in Chadwell Heath, Essex where the phones were held. GSL made no enquiries of 1st Freight and did not view the phones. There had been suggestions that the phones never were at that warehouse, but the Tribunal held that it was unable to make such a finding, although it did note that a visit might have revealed that the goods did not exist.

82. Mr Foulkes is highly critical of this conclusion and submits that it is clear that the phones did not in fact exist. He refers to [7] of the Decision to show the reasoning of the Tribunal. I do not propose to set this out but only note that it records certain visits by HMRC officers to the warehouse and what they did, or rather did not, find. The Tribunal did, in a passage relied on by Mr Wells, say this:

> "……Since it is quite possible that the phones were there on the basis that they were loaded that day, or that they left before the officers' visit, we cannot make a finding of fact that they were not there."

83. Mr Foulkes submits that that conclusion is not borne out in the light of evidence which was not referred to by the Tribunal. He says that there was clear evidence that 1st Freight was not operating a genuine business: goods purportedly handled

did not exist. He submits that, had the Tribunal addressed the totality of the evidence concerning 1st Freight, they would have been entitled to conclude that the goods did not pass through the warehouse. But even if a visit would not have revealed whether or not the phones existed, it is said that a visit would have revealed serious deficiencies in the operation and integrity of 1st Freight. Whatever might have been revealed, I agree with Mr Foulkes that it is clear that more should have been done in respect of verification of 1st Freight than was actually done and it appears that Miss Sexton accepted that. Moreover, I consider that, had the Tribunal taken into account all of the matters in evidence about 1st Freight, it would have been open to it to conclude that there were serious deficiencies in the manner and integrity of 1st Freight's operations and that, had they reached that conclusion, it would have formed a significant factor in their assessment of the evidence overall about what GSL ought to have known.

84. **Ground 18: significance of failure to conduct due diligence on Mr Murray**. The Tribunal stated that due diligence generally should have led to further investigation, noting in particular that there was no due diligence on Mr Murray. They identified the contrary argument as being that he was introduced to GSL by its chief financier, Mr Mhitarian and that GSL was unlikely to do anything which might have upset him. In my judgment, that factor cannot affect the result. The second limb of the *Kittel* test, as explained in *Mobilx*, equates what an objective trader ought to know with what he has the means of knowing. The desire not to upset a financier may be the reason why a trader fails to make the enquiries which he would otherwise make, but it cannot, I consider, have the result that he does not, objectively, have the means of knowing that which would have been revealed if he had in fact made the enquiries; in other words, he "ought to have known" that which an enquiry which would be made by the reasonable trader would have revealed. In any case, Mr Mhitarian was not only a financier but was a director who introduced the idea of conducting new mobile phone transactions in the first place. As the Tribunal explained his role:

> "The opportunity to participate in the new mobile phones market presented itself when one of the directors (Mr Erik Mhitarian) introduced Mr Ollie Murray, the sole director of MBG Associates Limited. Mr Mhitarian was the principal financier of the Appellant and was looking for higher returns for the Appellant at a time when the second-hand market was sluggish."

85. In these circumstances, it does not lie in the mouth of GSL to deny that it ought to have known that which would have been revealed by the sort of enquiry a reasonable trader would have made. But the Tribunal has, in effect, excused GSL from the consequences of a failure to carry out due diligence; they were, I consider, wrong to have done so.

86. **Ground 19: errors as to relevance of evidence referred to in [39] of the Decision**. [39] of the Decision is as follows:

> "We have given some contrary arguments in relation to each item. What is more important is to look at the totality of the items in the context of the Transaction itself. Unusually in chains in other MTIC reported cases this one seems far more commercial in that the Appellant's original purchaser went off, they were told that the purchase price had been renegotiated, and there was a delay in payment until 15 November 2006 as well as a dispute with CEMSA about the final amount of the payment resulting in retention of some of the phones. The Transaction does not satisfy Mr Fletcher's description of a normal grey market transaction but it is not clear that a normal trader would have understood this at the time."

87. Mr Foulkes has a number of criticisms of that which I deal with in the following paragraphs.

88. "**We have given some contrary arguments in relation to each item"**. In fact, the Tribunal gave no contrary argument in relation to items (3), (7) and (10) in [38] of the Decision. This allows Mr Foulkes to criticise the Tribunal for saying that it had dealt with "each item" when it had not and to submit that this supports the conclusion that they failed properly to consider the evidence and reached a conclusion which no tribunal acting properly could have reached.

89. "**the original purchaser went off**". The original customer did not so much "go off" as leave the scene because Mr Murray was not happy with it and wanted to find someone else. Mr Foulkes suggests that, whilst this may have reflected positively on the appearance that Mr Murray was conducting meaningful due diligence, it also provided further warning to GSL about the prevalence of fraud. I do not agree with that suggestion. If GSL should have been more cautious than it was about relying on Mr Murray, it was that reliance which can be prayed in aid as a factor in establishing what GSL ought to have known. The fact that the

original transaction came to nothing was not in my view, of itself, something which gave rise to an added ground for suspicion.

90. "**they were told that the purchase price had been renegotiated**". Mr Foulkes submits that it clear from this that the Tribunal considered this feature of the evidence to be an indicator of the genuine nature of the Transaction when in fact the opposite was the case. I do not think that this submission takes him any further than Ground 8 which is really all part and parcel of the same point.

91. "**there was delay in payment until 15 November 2006 as well as a dispute with CEMSA about the final amount of the payment resulting in retention of some of the phones**". Mr Foulkes submits that this evidence had no relevance to the issue of means of knowledge, as the delay in payment arose after the Transaction had been entered into. That may be so; but it does not mean that the evidence is irrelevant because what happened after the Transaction was entered into may throw light on the true nature of events which happened before or within the Transaction. I do not agree with him that the Tribunal were wrong to take this factor into account. I do, however, accept that it should not carry much weight, particularly given that the delay in delivery arose, as Mr Wells states, because of sterling currency fluctuations causing delay to the completion of the deal. For GSL, such a delay did not arouse suspicion. But suspicion or not at that stage is irrelevant since whether GSL "ought to have known" of a risk of fraud cannot depend on a genuine event outside its control causing a delay.

92. "**The Transaction does not satisfy Mr Fletcher's description of a normal grey market transaction but it is not clear that a normal trader would have understood this at the time**". As to that Mr Foulkes says this in his skeleton argument:

> "Mr Fletcher's evidence described the nature of the legitimate grey market in new mobile telephones, and the features that were apparent within it. It was implicit within this that a reasonable and competent trader operating within this market would be aware of such features. The particular features of the relevant transaction which did not accord with a legitimate grey market transaction are dealt with above: in particular the insufficient description of the goods, the absence of authorised distributors, manufacturers or retailers within the transaction (itself indicative of an artificially long and "un-commercial" deal chain) and the import to and export from the UK. It is clear from the description of the market that a legitimate trader operating within it would not be able to do so without a good understanding of how the market operated. Furthermore, the significance of the features noted above would be apparent even to a competent trader not familiar with the market."

93. For present purposes, that is an adequate description of Mr Fletcher's evidence. In referring to it in the way which they did, the Tribunal appear to be accepting Mr Fletcher's evidence. The issue for them, then, was whether the Transaction fell within the grey market as explained by Mr Fletcher which they considered it did not, although they regarded it as unclear whether a normal trader would have appreciated that.

94. Where did this take the Tribunal? They repeated the *Kittel* test, concluding, in [39] of the Decision in this way:

> "This is a high threshold which we do not consider HMRC has satisfied us on the balance of probabilities, taking the inherent probability of fraud into account, is the case here."

95. I am not clear why there are references to the balance of probabilities and to the inherent probability of fraud in this part of the Tribunal's reasoning. The *Kittel/Mobilx* test does not apply a balance of probabilities. On the contrary, it lays down a much more stringent requirement ("a high threshold" to use the Tribunal's words) so that there must be no reasonable explanation other than fraud. The "inherent probability of fraud" is already taken account of in the very nature of the test. It does not make much sense, in relation to that test, to say that HMRC have the burden of proving, on a balance of probabilities, that there is no reasonable explanation other than fraud. Either one adopts a balance of probabilities or one adopts no reasonable explanation as the appropriate test.

96. Be that as it may, it seems reasonably clear that the Tribunal had in mind the correct test, that is to say the "no reasonable explanation other than fraud" test concluding, in the light of all the evidence, that that test was not satisfied. They expressly stated that what was more important than looking at the separate contrary arguments (addressed to each particular factor relied on by HMRC as indicating a possibility of fraud) was to look at the totality of the items in the context of the Transaction itself. But this the Tribunal did not do. What they did in [39] of the Decision was to focus on one aspect of the Transaction, namely whether it was commercial or not, and then to rely on three factors (the original purchaser went off, GSL was told that the purchase price had been renegotiated, and there was a delay in payment until 15 November 2006 as well as a dispute with CEMSA about the final amount of the payment resulting in retention of some of the phones) to show that it was commercial.

97. Those three factors do not, in my view, give anything like a full picture. The Tribunal were right, of course, to say that what was important was the totality of the items in the context of the Transaction itself. But they did not, so it seems to me, carry out the overall assessment that that approach requires. It is one thing to address each item relied on by HMRC separately and then to give a contrary argument to each item (which is what the Tribunal did in relation to most items at least) but it is another to address the coincidence of all these items in one transaction and then to identify a plausible explanation for that coincidence or to say why the absence of one does not matter (which the Tribunal ought to have done but did not do). As it happens, the Tribunal did not, in any case, identify a contrary argument in relation to each item relied on by HMRC. Further, Grounds 2 to 19 articulate criticism of the contrary arguments where they were provided, nearly all of which have force and some of which seem to me to be correct. The Tribunal did not, in my view, adopt a correct approach to assessing whether GSL ought to have known whether the Transaction was connected with fraud.

98. In those circumstances, I do not consider that it is safe to rely on the ultimate conclusion of the Tribunal about "ought to have known". In my judgment, there has been an error of law on the part of the Tribunal which it is open to the Upper Tribunal to correct. The errors lie in the analysis by the Tribunal of the items which were relied on by HMRC as set out in [38] of the Decision and the

inadequacy of the so-called counter arguments, especially where HMRC had been given no opportunity to deal with them.

99. What relief it would be appropriate to give if the outcome of this appeal turned on the second limb of the *Kittel* test (*ie* the "ought to have known" limb") is a matter of some difficulty. I have not conducted a sufficient review of all of the evidence, including reading the entire transcript of the four day hearing, to be able to say whether the ultimate conclusion reached by the Tribunal was right or wrong. I would need to do so if I were to substitute my own view for that of the Tribunal. Indeed, even if I had reviewed all of this evidence, I might conclude that the appropriate course would be to remit the matter to the First-tier Tribunal to re-assess the evidence in the light of the discussion in this decision of Grounds 2 to 19 and of [39] of the Decision.

100. In the light of my decision on the first ground of appeal, namely that GSL is fixed with the knowledge of Mr Murray and thus of the fraud, it is not necessary for me to carry out a full review of the evidence in order to decide a difficult question of relief.

Disposition

101. HMRC's appeal is allowed. HMRC's original decision to refuse repayment of input tax to GSL is upheld. HMRC have indicated that they will seek their costs of the appeal. If that is opposed, a formal application should be made in accordance with the Upper Tribunal Rules or HMRC may seek alternative directions.

Mr Justice Warren
Chamber President

Release Date: 18 January 2012