TC01411

Appeal number: LON/2007/1758
LON/2008/0885

VALUE ADDED TAX – repayment of input tax refused – alleged MTIC fraud – whether transactions connected to fraud – whether actual and imputed knowledge of Appellant – contra-trading – whether knowledge of details of the fraud must be proved – transactions in clean chain taking place before transactions in dirty chain – whether conspiracy must be proved in contra-trading - appeal dismissed.

FIRST-TIER TRIBUNAL

TAX

DIGI TRADE LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
ANDREW PERRIN FCA

Sitting in public at 45 Bedford Square, London WC1 on 7, 9, 10, 11, 12, 14, 15, 16, 17, 18, 21, 22 and 25 February 2011. Further written submissions on 20 April, 2011 and 3 May, 2011

Andrew Young, Counsel, instructed by Dass Solicitors for the Appellant

James Waddington and Richard O'Brien, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against decisions of the Commissioners for Her Majesty's Revenue and Customs ("HMRC") to deny the Appellant's entitlement to the right to deduct input VAT. HMRC have refused the right to deduct input tax because it contends that the Appellant knew or ought to have known that the transactions which it entered into and which gave rise to its input tax claim were connected with the fraudulent evasion of VAT. This is, therefore, what is commonly known as a missing trader intra-community, or "MTIC", appeal. One feature of the appeal is that all the disputed transactions, except one, are alleged to involve what is called "contra-trading".

2. By a letter dated 12 October 2007, HMRC denied the Appellant's entitlement to deduct input tax in the amount of £462,290.68 claimed in respect of the purchase of computer Central Processing Units ("CPUs") and computer software in the VAT accounting period ended 31 March 2006 ("03/06") in the amount of £87,176.26 claimed on the purchase of CPUs in the VAT period ended the 30 June 2006 ("06/06").

3. In addition, by a letter dated 11 April 2008, HMRC denied the Appellant's entitlement to the right to deduct input tax in the amount of £14,542.50 claimed in respect of the purchase of CPUs and software in respect of the VAT period 03/06.

4. The decisions were issued after completion of an extended verification process conducted by HMRC. Notices of appeal in respect of the above decisions were filed, on behalf of the Appellant, on 15 October 2007 and 14 April 2008 respectively.

5. In their Statement of Case, HMRC contend that the Appellant's transactions formed part of transaction chains which were connected with the fraudulent evasion of VAT and that the Appellant knew or should have known of that fact.

MTIC transactions and contra trading – introduction

6. This appeal is mainly concerned with contra trading. HMRC allege that all deals but one (Deal 10 in period 03/06) concern contra-trading. Deal 10, so HMRC allege, forms part of a simple tax loss chain where the Appellant acts as a broker/exporter (see below as regards terminology).

7. The concept of MTIC transactions and contra-trading is, by now, well-known. Essentially, contra-trading is a variation on basic MTIC trading. The contra-trader attempts to disguise its export transactions by engaging in a separate series of transactions where its role involves the making of standard rated supplies. A good description is contained in the decision of the VAT and Duties Tribunal decision in *Livewire Telecom Ltd v HMRC* [2008] V&DR 131 (Dr John F Avery Jones CBE (Chairman) and Sheila Wong Chong FRICS) as follows:

"In order to demonstrate where the loss of tax arises from MTIC fraud we start with a simple example of an import of goods by X who sells them to Y who exports them. The tax on acquisition (import) by X is cancelled by input tax of the same amount, and the output tax charged on sale by X will be cancelled by input tax repaid to Y on the export, so that the United Kingdom exchequer receives no net tax. If both X and Y are fraudsters Y will have to finance the output tax charged by X, which is recovered by X not paying the output tax to Customs. The only gain by the fraud is if Customs pay the input tax to Y when the exchequer is left with a loss of the amount of the input tax; the non-payment of output tax by X is merely the recovery of what Y put in. If the exporter is innocent of that fraud he is entitled to repayment of the input tax that he has actually paid to X even though this represents tax never paid by A [the missing trader] and the exchequer is left with the same loss of the amount of the input tax.

... [T]his appeal is concerned with contra-trading. In contra-trading there are, in its simplest theoretical form, two chains of transactions. First, the "dirty chain," in which there is a missing trader, defaulting trader, or trader using a hijacked VAT number ("missing trader" for short), comprising A (the missing trader) who is the importer of goods into the UK, who sells them to B, who sells them to C who exports the goods, and is thus in a VAT reclaim position. (For simplicity we shall use the expressions import and export for intra-Community trade, acknowledging that these are not the proper labels.) Secondly, the "clean chain," in which there are no missing traders, comprising C, who is this time the importer, who sells to D, who sells to E, the exporter (the Appellant in this appeal is in the position of E). The effect of the clean chain is that the net input tax position of C in the dirty chain is cancelled by output VAT in the clean chain. There is no benefit to C in this as C has paid the input tax to B, and therefore C could be a trader who happens to carry out both import and export transactions unconnected with any fraud, or C could be a trader who is controlled by a "puppet master" to enter into the cancelling transactions to disguise A's involvement in a fraud. The effect of the contra-trades is that C does not excite Customs' attention as it is not applying for a repayment; the non-payment of tax by A is less noticeable since without a return Customs do not know how much tax A owes. The input tax reclaim that C had in the dirty chain has moved to E who is at the end of a clean chain. The only way for Customs to refuse repayment of E's input tax is to show that E knew or ought to have known of A's fraud in a completely different chain, and possibly of C's involvement. Since ... the only gain from A's fraud is the recovery of input tax by E this must imply that E is a participant in the fraud and, unless he is the puppet-master, is presumably sharing the tax recovered with someone else. As Mr Scorey pointed out it is difficult to see how a case of E having means of knowledge, rather than actual knowledge, can arise.

The nature of contra-trading is easy to state in the above way but the problem in real life is that there is no logical connection between the clean and dirty chains. First, the VAT accounting periods for C and E will not coincide; E may be on a monthly accounting period as it is a

> habitual exporter, but C may be on a three-monthly period, and C need only arrange that the net tax is nil during that three-monthly period by entering into transactions after E's transactions. Secondly, the goods dealt in may be different in the two chains. Thirdly, for a particular C there may be many different equivalents to A and E, and for a particular E there may be many equivalents of C, each with more than one equivalents to A. Fourthly, C may not have deliberately entered into imports in the clean chain in order to cancel the input in the dirty chain; C may merely be both an importer and an exporter whose outputs in relation to the former happen roughly to cancel its inputs in relation to the latter. Fifthly, there may be many Bs and Ds in between the importer and exporters."

8. It is, perhaps, worth observing, in relation to the point made in the last paragraph by the Tribunal in relation to different accounting periods, that transactions in the dirty chain may take place after transactions in the clean chain.

9. For convenience, we shall adopt the same terminology of "importing" and "exporting". For simplicity and without pre-judging the issue, we shall also refer to "clean" and "dirty" chains (or "contra chains" as an alternative description of "clean" chains) and whilst recognising that in fraudulent transactions involving contra-trading, HMRC contend that there is no such thing as a "clean" chain. Also, again without prejudging the issue, we adopt the common terminology of referring to the exporter (the Appellant in the present appeal) as the "broker". In addition, we refer to the companies in between the importer and exporter as "buffer" companies and we refer to an importer as an "acquirer". We also use HMRC to include its predecessor HM Customs and Excise. We refer interchangeably to HMRC and the Respondents.

Witnesses and documentary evidence

10. The Tribunal was supplied with thirty-eight lever arch files of documents, containing mainly witness statements and exhibits to witness statements. A transcript of the evidence was taken, although (with the exception of the Appellant's opening statement) no transcript was taken of counsel's opening and closing submissions.

11. At the outset of the appeal, it was agreed that the witness statements of each witness could stand as their evidence in chief, although both counsel helpfully took their witnesses briefly through the main points of their evidence.

12. As regards HMRC's witnesses, witness statements of Officer Fu Sang Lam (in relation to the defaulting trader West 1 Facilities Management Ltd ("West")) and Officer Robert Lamb (in relation to the defaulting trader Roble Comm Limited ("Roble") were agreed and therefore these two officers did not give oral evidence.

13. Officer Laura Hartell submitted a witness statement and gave oral evidence, mainly in relation to a defaulting trader called Data Solutions Northern Ltd ("DSN") which appeared in one deal ("Deal 10") on 31 March 2006. Deal 10 was the only deal chain which, HMRC alleged, did not involve contra-trading.

14. Officer David Berry submitted witness statements and gave oral evidence, mainly in relation to the alleged contra-trader HKS Trading Limited ("HKS") and, in particular, the returns submitted by HKS for 05/06.

15. Officer Emma Cooper submitted witness statements and gave oral evidence, mainly in relation to the alleged contra-trader HKS and returns for 08/06 and also in relation to the alleged defaulting trader Hits & Clicks Limited.

16. Officer Mark Wood submitted a composite witness statement and gave oral evidence. Officer Wood was the HMRC officer responsible for the Appellant.

17. Officer Dave Hancox submitted a witness statement and gave oral evidence in relation to transactions involving First Curacao International Bank ("FCIB").

18. Officer Peter Dean submitted a witness statement and gave oral evidence in relation to the Appellant's transactions in CPUs.

19. Officer Roderick Stone submitted a witness statement and gave oral evidence in relation to the background of MTIC fraud.

20. Dr Kevin Findlay gave expert evidence in the form of a witness statement and gave oral evidence in relation to the grey market in CPUs.

21. Mr Richard Peake gave expert evidence in the form of a witness statement and oral evidence in relation to E-Auz software.

22. For the Appellant, both Mr Iffat Shah (a shareholder and director of the Appellant) and Mr Irshad Mohammed (a director of the Appellant) submitted witness statements and gave oral evidence.

Credibility and reliability of certain witnesses

23. We wish to make some preliminary comments about the credibility of certain witnesses, before recording our findings of fact.

Officer Wood

24. The reliability of Officer Wood’s evidence came under sustained challenge from Mr Young on behalf of the Appellant.

25. In particular, Officer Wood was criticised for including in his composite witness statement, which represented a combination of two earlier witness statements and which this Tribunal directed should be consolidated, a statement in relation to the Appellant's VAT returns which was true when made as part of the earlier statement but was incorrect when he signed the statement of truth in relation to the composite statement. Officer Wood said, and we accept, that he mistakenly believed that everything in his previous statements had to be included in the composite statement. This was plainly an error of judgement and represents a failing by the Respondents to inform their witnesses of their responsibilities in relation to filing composite witness statements.

26. Officer Wood was also criticised by Mr Young for confirming that his witness statement was his own work even though it appeared that some of his words (general comments explaining the nature MTIC fraud) appeared to have been taken from other witness statements. Officer Wood conceded that he had used a standard form of words. In our view, this did not call Officer Wood's truthfulness into question. It is perfectly possible for a witness to use a standard form of words in a witness statement, if those words accurately reflect the understanding and meaning of the witness, and for the witness to regard himself as having written the witness statement without the witness being untruthful.

27. Officer Wood was also criticised because he stated that he had not used the "cut-and-paste" function on his computer when he had used the standard departmental form of wording to describe MTIC fraud. His evidence was that the cut-and-paste function on his computer was unreliable, although he subsequently accepted in his evidence that he had used this function on a later part of his witness statement. We did not consider that this inconsistency indicated that Officer Wood was untruthful or unreliable and we considered that the inconsistency was simply a matter of forgetfulness.

28. In addition, Officer Wood was criticised for including numerous statements of opinion in his witness statement. He was also criticised for making certain statements without exhibiting the underlying documents. We accept that these are valid criticisms. Officer Wood appeared as a witness of fact and not an expert witness. The opinions of a witness do not constitute evidence and, except in limited circumstances, should form no part of a witness statement.

29. However, we do not accept the submission made on behalf of the Appellant that these (and other) defects rendered Officer Wood's evidence unreliable. It is true that Officer Wood appeared to have little or no commercial experience, having served in the public sector for all or most of his career rendering his opinions (which in any event did not constitute evidence of fact) sometimes unrealistic. Nonetheless, we considered his evidence reliable and honest and we were able to disregard statements of opinion and other irrelevant or unsupported material. We do not consider Officer Wood’s evidence to have been biased or prejudiced and therefore unreliable.

Dr Findlay

30. Dr Findlay was called as an expert witness by HMRC as regards the grey market in CPUs. His evidence was challenged by the Appellant, inter alia, on the basis that he lacked the necessary expertise in the grey market and could not give evidence as to the number of CPUs that were manufactured. It was argued that he did not have adequate information on which to prepare his report. He was also criticised in relation to a suggestion that Intel destroy surplus CPUs, a suggestion which he retracted on his own initiative. There was also a submission that Dr Findlay was conflicted because of overtures made by PwC to the Federation of Technological Industries ("FTI") and communications with traders in the IT sector.

31. We do not accept the criticisms of Dr Findlay. We found Dr Findlay to be a knowledgeable, objective and credible witness. We did not accept that he was conflicted or compromised.

Mr Shah

32. Mr Shah gave evidence on behalf of the Appellant. He was a director and 50% shareholder of the Appellant.

33. We did not consider Mr Shah to be a credible witness. His replies in cross-examination were frequently evasive and, we consider, in a number of respects untruthful. He frequently avoided giving a direct answer to questions preferring instead to give lengthy replies which did not bear directly on the questions asked. In cross-examination, he often professed ignorance of Mr Mohammed's actions and distanced himself from the actions of Mr Mohammed in a fashion which we did not find credible.

Mr Mohammed

34. Mr Mohammed gave evidence on behalf of the Appellant. He was a director of the Appellant and ran its business on a day-to-day basis.

35. We did not consider Mr Mohammed to be a credible witness. Like Mr Shah, his replies in cross-examination were often evasive and, we consider, in a number of respects untruthful. Similarly, he frequently avoided giving a direct answer to questions preferring instead to give lengthy replies which did not bear directly on the questions asked. On a number of occasions he gave answers to questions which we considered were not credible.

General

36. The above comments are of a general nature. We shall, as necessary, comment further on the evidence of particular witnesses in relation to specific issues later in this decision.

Submissions of the Parties

37. Both parties filed skeleton arguments. At the request of the Tribunal the closing submissions were in written form and were also presented orally by counsel. In addition, further written submissions were made by the parties (20 April, 2011 by the Respondents and 3 May, 2011 by the Appellant) at the request of the Tribunal made on 25 March, 2011 in relation to the decision of the Upper Tribunal in *HMRC v Brayfal Limited* FTC/53/2010 delivered on 2 March 2011.

Background facts

38. The following facts were undisputed.

39. The Appellant was incorporated on 9 October 2003.

40. The Appellant was registered for VAT on 5 January, 2005 with effect from 1 November, 2004. The Appellant's principal place of business was a serviced office

at Unit 6, The Kingfisher Exchange, Third-floor, Kingfisher House, Walton Street, Aylesbury, Buckinghamshire.

41. After HMRC decided to refuse the Appellant's claim to repayment of import tax, which is the subject matter of this appeal, the Appellant ceased trading (in or around July 2006).

42. The officers of the Appellant at times material to this appeal were as follows:

(1) Irshad Mohammed was appointed as a director on 2 November, 2004;

(2) Khalid Khan and Iffat Shah were appointed as directors on 23 October, 2004. They resigned as directors on 1 November, 2004 but were reappointed on 17 May, 2006.

(3) Cheng Hua Miao (wife of Irshad Mohammed) was appointed company secretary on 23 October, 2004.

43. Mr Khan and Mr Shah were the shareholders of the Appellant, each holding one of the of the company's two £1 ordinary shares (issued share capital of £2).

The transaction chains

44. We set out in Appendices to this decision summaries of the transaction chains relevant in this case involving the Appellant and the alleged contra-trader, HKS. The deal chains were based on the evidence of primarily Officers Wood, Hartell, Berry, Cooper, Lam and Lamb. The chains include those which involved the Appellant -- which HMRC described as the “contra chains”: see Appendices 1 and 3. Appendix 2 sets out the one “tax loss chain” to which the Appellant was a party (“Deal 10”). The other Appendices (4 and 5) include the tax loss (or so-called dirty) chains involving the alleged contra-trader, HKS where HKS acted as broker (i.e. it exported the goods). HKS, as an alleged contra-trader, is, of course, involved in both the clean and dirty chain, but was not involved in Deal 10 in 03/06.

45. The accuracy of these transaction chain summaries was not in dispute between the parties and we find the summaries in the Appendices as fact.

46. The transactions described in Appendices 1, 2 and 3 were the only deals concluded by the Appellant during the two VAT periods in question (03/06 and 06/06).

47. There are a number of comments that can be made on the contra deal chains and Deal 10 in period 03/06 (the one deal chain in which there was a tax loss in the deal chain involving the Appellant).

48. First, in all the contra chain deals in the periods 03/06 (with the exception of Deal 10 in period 03/06) and 06/06 the Appellant's immediate supplier was a UK resident company called Churchill International Trading Limited ("Churchill").

49. Secondly, in all those contra chain deals (again, with the exception of Deal 10 in period 03/06), the UK portion of the chain starts with a UK company, HKS, the

acquirer, which sells to Churchill which, in turn, sells to the Appellant which acts as a broker. These companies appear in the same order in all those deals. HMRC allege that HKS was a fraudulent contra-trader.

50. Thirdly, in all the contra chain deals in the period 03/06 (again, with the exception of Deal 10 in period 03/06) the EU supplier to the UK acquirer (HKS) was a French company called EURL Corinth ("Corinth"). In all the contra chain deals in the period 06/06, the EU supplier to the UK acquirer (HKS) was a Portuguese company called World Tagus Trading Unipessoal LDA ("World Tagus").

51. Fourthly, in Deal 1 in the period 03/06 the Appellant exported to a Swiss company called Bergmann Associates AG ("Bergmann"), in Deal 2 in the period 03/06 the Appellant exported to a Netherlands company called Trius Distribution Channels BV ("Trius"). In Deals 3 and 10 in the period 03/06, the Appellant exported to a Netherlands company called Solid Storage Systems BV. In Deals 4, 5, 6 and 7 the Appellant exported to a company in Dubai called E-Future Systems FZE ("E-Future"). In Deals 8 and 9 in the period 03/06 the Appellant exported to a Turkish company called Zi Enterprises Tek Urun Ve Dis Tic Ltd ("Zi Enterprises").

52. Fifthly, in all five deals in the period 06/06 the Appellant exported to E-Future.

53. Sixthly, in all the deals involving Intel Pentium CPUs (excluding Deals 8 and 9 in period 03/06 where the goods comprised software and Deal 10 in the same period, where the members of the chain were different), the mark-ups made by HKS and Churchill were always £0.25 and £0.20 per unit respectively, regardless of the quantity or unit price of the goods concerned. In the two deals involving E-Auz software (Deals 8 and 9 in the period 03/06), the mark-ups for HKS and Churchill were £0.50 per unit each.

54. Seventhly, the per unit mark-up made by the Appellant varied in each deal. In the period 03/06 the mark-ups were as follows: Deal 1 £ £9.50, Deal 2 £3.90, Deal 3 £3.69, Deal 4 £3.49, Deal 5 £4.13, Deal 6 £5.75, Deal 7 £2.24, Deal 8 £5.60, Deal 9 £2.00, Deal 10 £4.55. In the period 06/06 the mark-ups were as follows: Deal 1 £4.34, Deal 2 £5.99, Deal 2a £4.56, Deal 3 £6.73 and Deal 3a £4.98.

55. Finally, in every deal except Deals 8, 9 and 10 in the period 03/06, the Appellant paid its supplier before being paid by its customer. As regards Deals 8 and 9, the Appellant paid its supplier on the same day that it received funds from its customer. As regards Deal 10 details were not available in relation to the date on which the Appellant paid its supplier.

Background evidence in relation to MTIC fraud: Officer Stone

56. Officer Stone is a senior HMRC official, with responsibilities for and experience of the investigation and combating of MTIC fraud for the past 10 years.

57. His statement gave an overview of the background and history of MTIC fraud and HMRC's response to it. The statement was largely generic and, in the main, did not refer to this particular appeal.

58. Officer Stone stated that, in July 2005, HMRC had identified contra-trading as a measure introduced by those involved in MTIC fraud to counteract interventions made by HMRC.

59. He gave details of an investigation by the Dutch authorities into FCIB. Officer Stone stated that the investigation was still continuing and is being conducted by the economic crime unit in the Netherlands. He also confirmed that the Dutch authorities provided HMRC with a copy of the banking server of FCIB, with access being given to HMRC in August 2008. In addition, HMRC have had access to an FCIB server based in Paris since January of this year.

60. Officer Stone gave details of the measures taken by HMRC against MTIC fraud, including detailed verification of repayment claims, directions made under Regulation 25 of the VAT Regulations 1995 (which shortened VAT accounting periods and shortening the date by which returns must be made), validation by traders of the VAT registration numbers of potential suppliers and customers of traders by the HMRC offers at Redhill, notification of traders of the cancellation of the VAT registration of missing traders, joint and several liability under section 77A of the VAT Act 1994 (as amended in 1997).

61. Officer Stone described the change in trading patterns connected to MTIC fraud in response to measures introduced by HMRC, including:

- in 2002, the use of third-party payments in response to HMRC's use of freezing orders in civil recovery actions against missing traders

- In 2002-03, countermeasures to stop HMRC demonstrating circularity in a transaction chains and thus applying a non-economic activity argument to deny input tax. For example, those operating the fraudulent chains lengthened the transaction chains and introduce more traders outside the UK, whose business records HMRC could not easily obtain. In 2002-03, the introduction of third-party payments to unrelated parties to stop HMRC demonstrating circularity transaction chains on the basis of records of payments and thus applying a non-economic activity argument to deny input tax.

- From 2003, an increase in the use of defaulting traders in response to the introduction of joint and several liability.

- From 2005, an increase in exports to non-EU countries in response to HMRC's engagement with the tax administrations in other EU Member States to evidence transaction chains.

- From 2005, the opening of offshore bank accounts at the FCIB by traders whose transactions were connected to MTIC fraud.

- From 2005, in response to HMRC withholding VAT repayments whilst they verified claims, the introduction of contra-trading.

62. In cross-examination, Officer Stone confirmed that the chairman and sole shareholder of FCIB, Mr John Deuss, had been charged with a criminal offence and had been released on bail. Mr Young also asked Officer Stone whether the primary reason for the investigation by the Netherlands and Netherlands Antilles authorities into FCIB was a regulatory problem relating to licences. Officer Stone acknowledged that there were regulatory issues but added that the Netherlands authorities were investigating money laundering by FCIB and that investigation was continuing. He accepted that traders would not know about problems concerning FCIB until about August 2006.

63. Officer Stone also accepted that a great deal more was known about MTIC fraud today than was known in 2006, although obviously those who participated in the fraud knew more at that time.

64. He accepted that there was a legitimate grey market in goods that were commonly used in MTIC fraud transactions.

65. Officer Stone was asked, as regards traders who were not active participants or co-conspirators in the fraud, what indicators of contra-trading were available in 2005/2006. Officer Stone replied that there was nothing specific. He said that the transactions in a contra chain were identical in some ways to transactions in a tax loss chain -- the only difference was that there was no deliberate tax loss at the point of acquisition. Officer Stone had first looked at the issue of contra-trading in July 2005 and it was in approximately October/November 2005 that HMRC considered there was a problem with contra-trading. Officer Stone considered that contra-trading was quite easy to spot, but accepted that it would be very difficult for a legitimate trader to identify. However, he considered that the risks for the exporter who was involved in a tax loss chain directly and in a contra chain were the same. In both cases the same degree of care needed to be taken because it would not be clear that there was a tax loss at the beginning of either chain.

66. Mr Young asked Officer Stone what indicators would there be to an innocent trader who was involved in a contra chain that they could somehow be associating themselves with contra-trading. Officer Stone replied that the commodity itself could be one that fell within the joint and several liability provisions (e.g. mobile phones or computer-related equipment) which required the trader to look at the integrity of the transaction chains and the matters surrounding the transaction chain. Also, the pattern of trading could be an indicator in as much as the goods were trading through warehouses that may be involved in tax loss chains or previously involved in tax loss chains or the trader was trading with persons whose credentials were less than credible. Mr Young put to Officer Stone that an innocent trader in a contra chain dealt with its immediate supplier or customer and had no reason to suspect that anything was amiss. Officer Stone replied that the same claim could be made of the tax loss chain, if the trader was not party to the tax loss of the beginning of the chain. Officer

Stone did not agree that there was no objective way for a trader to discern whether he was involved in a contra trade chain unless he was actually a co-conspirator. It was necessary, said Officer Stone, to look at the credibility of your customers and suppliers and others involved.

67. Officer Stone denied that any decision had been taken not to publicise contra-trading. HMRC's view was broadly the same rules applied to contra-trading as to tax loss chains. If a trader was genuinely not involved in the fraud, he should be applying the same risk assessment to contra chains as it should be to tax loss chains.

68. In reply to Mr Young's question, Officer Stone accepted that in 2005/2006, HMRC officers would not have mentioned contra-trading to traders.

69. Mr Young asked Officer Stone, in relation to contra-trading, at what point the fraud crystallised. He considered the fraud crystallised on the VAT repayment. The instrument of the fraud was obviously the missing trader. The beneficiaries from the fraud were those who financed it and took the profit from it. It was not necessarily the missing trader who made the money from the fraud. In most cases the missing trader never received sufficient funds actually to pay HMRC. The money was dissipated amongst the other parties in the transaction chain.

70. Officer Stone considered that a contra-trader, by balancing its inputs and outputs, was seeking to deceive HMRC. In addition, the contra-trader was also seeking to increase the size of the fraud. By employing more brokers, a greater amount of tax would go missing -- it was much like pyramid selling. Officer Stone accepted that a contra-trader could be trying to deceive others, but considered that the contra-trader would obviously want to trade with people that it trusted because the flow of money passes through the broker to the contra-trader. In his view the contra chain was simply an extension of the dirty chain.

71. Officer Stone acknowledged that HMRC thought that frequently the freight forwarders were facilitating the fraud. The freight forwarder in contra chains was frequently different from the freight forwarder in the tax loss chain.

72. Officer Stone was not aware of any third-party payments involved in the present appeal. However, he was not able to confirm whether in the present appeal any of the other factors listed in paragraph 61 above were present. However, in relation to an increase in exports to non-EU countries he recollected that there were non-EU exports in the present case.

73. Officer Stone believed that the Appellant did not have an FCIB account. He was asked if that was suspicious. He replied that if the counterparties had FCIB accounts, bearing in mind the amount of publicity in 2006 alleging that UK bank accounts were being closed, it should have raised concerns and should have formed part of the risk assessment conducted by the exporter. Officer Stone did not accept that UK bank accounts were closed as a result of pressure from HMRC.

74. Officer Stone stated that the joint and several liability provisions of section 77A of VATA 1994 had not been applied to the Appellant. These provisions were the

subject of a challenge before the European Court of Justice and a decision was given by the Court in July 2006. By that time HMRC had adopted a different approach, viz to deny input tax based on whether a trader knew or ought to have known that his transactions were connected with fraud.

75. Officer Stone was asked in cross-examination about Redhill checks, where traders were invited to verify the VAT registration of their trading partners. Mr Young asked whether a trader who did one trade per day every day of the week was expected to verify its customer/supplier VAT registration for every trade or just on the introduction. Officer Stone said that traders were asked initially just to do it on the introduction but some of them chose to do it more frequently as part of their risk assessment. Officer Stone confirmed that there was nothing in any official guidelines requiring Dun & Bradstreet checks. Traders were expected to conduct their own operational risk assessment. It was a matter for the trader to assess all the information available to make a decision on whether or not it wanted to enter into a transaction.

Connection to fraud: evidence relating to the defaulting traders and the contra-trader (HKS)

76. HMRC have in the first place to show that the Appellant's transactions were connected to the fraudulent loss of VAT. To this end, HMRC relied principally on the evidence of Officers Hartell, Lam, Lamb, Berry and Cooper. The relevant evidence of these witnesses is summarised below. The Appellant accepted that there were tax losses flowing from Roble and West, but put HMRC to proof that the Appellant's transactions were connected with the fraudulent evasion of VAT.

Evidence of Officer Hartell – Data Solutions Northern Limited ("DSN")

77. Officer Hartell's evidence mainly concerned the defaulting trader in Deal 10: DSN. The relevant deal chain is summarised in Appendix 2.

78. Officer Hartell was appointed the Officer for DSN on 9 June 2009. Her evidence was, therefore, largely based on the previous officer's work - the information was held on HMRC's electronic system and in hard copy format on HMRC's files.

79. DSN was incorporated on 7 January, 2005 and applied for registration for VAT on 17 January, 2005. Its principal place of business was in Thornton, Bradford. According to its application for registration on Form VAT 1, DSN did not expect VAT repayments to be made. Its main business activity was to be the "…buying and selling of data. Purchase and sale of mailing lists". Its expected turnover was estimated to be £200,000 in the next 12 months. The application for registration was signed by DSN's director Keith Thelwell, who carried out the day-to-day activities of the business. DSN was registered for VAT with effect from 31 March, 2005.

80. DSN was put on quarterly returns and had VAT periods ending February, May, August and November.

81. HMRC obtained information that DSN might be trading with other businesses that had been subject to MTIC enquiries. Consequently, two HMRC officers visited DSN on 14 July, 2005. They explained the risk of MTIC fraud at length to Mr Thelwell.

82. A copy of Public Notice 726 "Joint and Several Liability in the Supply of Specified Goods" was issued to Mr Thelwell. The Notice applied to "specified goods" i.e. computers and any other equipment, including parts, accessories and software, made or adapted for use in connection with computers or computer systems. The Notice stated that a trader could be held liable for VAT if the trader knew or had reasonable grounds to suspect that the VAT on a taxable supply (or any previous or subsequent supply) of specified goods from another VAT registered business would go unpaid to HMRC. The Notice suggested checks that the trader could undertake to ensure the integrity of its supply chain.

83. It was noted at this meeting that DSN bought goods from a company called Salamander. It was further noted that DSN had made payments to third parties at the request of Salamander. It was pointed out to Mr Thelwell that if third-party payments were made, Salamander would have insufficient money to cover its VAT liability.

84. Mr Thelwell was also asked whether he had made any purchases from Ennocx (UK) Ltd ("Ennocx"). Mr Thelwell stated that he only made purchases from Salamander. However, HMRC held information which showed that DSN had made purchases from Ennocx. The information consisted of sales invoices from Ennocx to DSN and stock allocation notes.

85. Mr Thelwell conceded that DSN did not have insurance cover for goods whilst they were in its possession; they had not undertaken any kind of due diligence on its suppliers; and it made decisions to trade with companies based on its personal knowledge of the customer and/or supplier.

86. After this visit, HMRC considered DSN to be a "buffer" trader (i.e. a trader who would be a link in the chain between the defaulting trader and an exporting broker).

87. Mr Thelwell had previously worked for a company called Cobra Trading Ltd ("Cobra"), a suspected MTIC trader.

88. Mr Thelwell's current business, DSN, made third-party payments to a German company called Eurohandels GmbH. Eurohandels featured in the supply chains of Cobra in July, August, September and November 2003. DSN was supplying Ennocx in April 2005. Then, in the following three months of June, July and August 2005, the roles were reversed and Ennocx supplied DSN. Ennocx was also in supply chains with Cobra in July, September and November 2003.

89. On 21 July, 2005 DSN was advised by HMRC that Ennocx had been de-registered for VAT with effect from 21 July, 2005. HMRC wrote to DSN on 3 August, 2005 requesting that DSN verified the VAT status of new customers and suppliers.

90. On 10 August 2005, HMRC officers visited DSN to discuss freight forwarder release notes held by HMRC and to establish why they did not correspond to the dates on the invoices issued by Mr Thelwell – the transaction in question had not been mentioned by Mr Thelwell during the 14 July visit. Mr Thelwell stated that only a few deals had gone through since the last visit by HMRC and he had not mentioned them at that time because they were "only in the pipeline". The deals were believed to involve about 100,000 Nokia mobile telephones. Mr Thelwell confirmed that he had opened an account with FCIB. Mr Thelwell denied having traded with Ennocx. He was shown the documents which indicated that DSN had traded with Ennocx. Mr Thelwell was unable to explain this and told the officers that he had not undertaken any of these deals. In response to questions about the data in relation to DSN's transactions, Mr Thelwell admitted backdating deal dates.

91. In another visit by HMRC officers on 24 January, 2006, it became apparent that DSN was now trading primarily in SMS numbers. Mr Thelwell confirmed that he was carrying out due diligence checks and that this information was contained within the deal packs.

92. On 9 February 2006 DSN began to verify VAT numbers with HMRC's National Contact Centre. HMRC recorded 41 telephone contacts and one fax enquiry requesting verification of VAT numbers. The last verification request was recorded as 18 August, 2006.

93. On 11 May, 2006 HMRC visited DSN's new premises. During that visit Mr Thelwell was advised that he should not risk trading with counterparts unless he had a response from HMRC's Redhill office. Mr Thelwell confirmed that he had not acquired or purchased from the EU. He said that he had been approached by prospective EU-based suppliers. The main business activity of DSN was data packet work, SMS and MMS telemarketing information. The current trade was in mobile telephones and processors, although Mr Thelwell told the officers that supply was low. Suppliers at the time were identified as Midwest Communications Ltd ("Midwest") and Bulfinch Systems Ltd ("Bulfinch"). Midwest was subsequently deregistered VAT on 3 May, 2006 as an MTIC defaulter with a tax debt exceeding £58 million. Mr Thelwell was challenged about the lack of due diligence carried out by DSN. He indicated that "he hadn't got round to it yet" and he had had no time. HMRC requested copies of documents relating to deals done on 5 and 9 May, 2006.

94. The following day, on 12 May, 2006, the officers returned to DSN's premises to collect records and documentation. They were informed by a note on the door frame that the paperwork been left with DSN's accountants.

95. HMRC checked an "introductions file" provided by DSN and found that five of the seventeen traders mentioned therein were found to be MTIC defaulting traders.

96. On 17 May, 2006 HMRC sent a letter to DSN informing Mr Thelwell that all of DSN's transaction chains in the VAT period 05/06 had begun with a defaulting trader and had resulted in a tax loss of over £12,800,000.

97. At a further visit to DSN's offices on 24 May, 2006, HMRC officers discussed the outstanding VAT records for the VAT period 02/06. Mr Thelwell agreed to examine a schedule prepared by HMRC from previous records they had examined. The Officers asked why there appeared to be missing invoices. DSN did not hold any stock and asked where the goods have been sold. Mr Thelwell said he was unaware that there were gaps in his records. A copy of the schedule was left with Mr Thelwell to enable him to look into the matter. Some records relating to invoices and FCIB bank records for the 02/06 period were taken away.

98. On 30 May, 2006 HMRC sent to DSN a letter querying the missing invoices relating to the onward sale of goods which have been discussed at the visit on 24 May, 2006. In addition, documentation was requested relating to a sales invoice number 31/Mar/f. An e-mail response from DSN promised the information on 12 June, 2006. HMRC sent a reminder on 12 June, 2006 requesting the additional deal documentation in relation to that invoice.

99. DSN continued to verify traders VAT numbers via the National Contact Centre throughout June and July 2006.

100. On 1 August 2006 HMRC sent DSN a letter requesting the deal documentation relating to 2 transactions in March 2006.

101. On 11 September, 2006 HMRC sent DSN a letter requesting contact within seven days and stating that a failure to do so would result in the company being deregistered. There was no response to this letter and DSN was therefore deregistered with effect from 8 September 2006.

102. On 27 September, 2006 liquidators were appointed for DSN. The liquidators, at the request of HMRC, forwarded to HMRC details of FCIB transactions undertaken by DSN. The liquidators supplied further information in August and September 2006.

103. On 29 May, 2008, the liquidators wrote to HMRC confirming that they had no contact with Mr Thelwell and that it was their understanding that he lived abroad.

104. On 29 May, 2009, HMRC received a letter from the Insolvency Service (to which HMRC had previously provided information relating to DSN and Mr Thelwell) which advised that on 4 February, 2009 Keith Thelwell had been disqualified as a director. It had been found that Mr Thelwell was unfit to be concerned in the management of a limited company, as he had caused or allowed DSN to undertake a method of trading which involved it in, and put HMRC at risk of, being subject to VAT fraud.

105. In June 2007 HMRC were notified of details obtained during visits undertaken by HMRC to certain freight forwarders. These indicated that DSN had undertaken a number of transactions with EU traders in which it imported CPUs in April and May 2006 (and, on one occasion, mobile phones in May 2006).

106. In addition, the liquidators of DSN provided a bank account analysis spreadsheet which detailed large payments from DSN to non-UK companies, thus supporting the freight forwarder information.

107. After being appointed as the officer responsible for DSN on 9 June, 2009, Officer Hartell undertook further investigations into the freight forwarder information. She found further release notes and freight forwarder visit reports that demonstrated that DSN was acquiring goods from outside the UK.

108. Other officers had initiated a number of replacement and additional assessments against DSN in respect of the VAT periods 5/06 and 08/06 and the final period in which the Appellant traded. Officer Hartell reviewed this information and found the previous assessment action unclear and confusing. She therefore reconstructed the assessment schedules for those VAT periods. In the course of doing this she discovered 25 deals where HMRC only held purchase invoices from Midwest with no corresponding onward sale being made by DSN. She concluded that these 25 purchases must have been sold on, because DSN did not have premises or storage facilities to hold stock and had always carried out back-to-back deals.

109. To calculate the amount of tax due on the 25 purchases from Midwest, Officer Hartell calculated the average mark-up DSN had applied to the 77 purchases from Midwest with a known mark-up in period 05/06. On that basis, she calculated the tax that would have arisen on the on-sales using a best judgement method of calculation. She produced new schedules which showed a tax debt of £8,763,704.30. Officer Hartell, in her oral evidence, confirmed that a tax loss had been identified in DSN in relation to a supply chain leading to the Appellant in March 2006. The deal in question related to DSN sales invoice number 31/Mar/f. HMRC held two sales invoices with that number. She confirmed that output tax in relation to that transaction (i.e. the transaction in the chain which led to the Appellant exporting goods) was included in the total liability assessed against DSN.

110. Officer Hartell confirmed that in a period of just 18 months, since first becoming VAT registered on 31 March, 2005, DSN had managed to make sales in excess of £247 million. The total tax losses identified to date by HMRC in respect of DSN was approximately £12.8 million.

111. In cross-examination, Mr Young questioned Officer Hartell about her conclusion that because DSN did not hold or store stock it must have sold on 25 purchases from Midwest. Officer Hartell conceded that a business such as DSN's would be expected to use freight forwarders.

112. Officer Hartell also confirmed that she had not done the HMRC basic VAT course and that she had not raised any of the assessments herself, although she had reviewed the assessments issued by other officers.

113. Mr Young queried the method by which Officer Hartell had calculated the average mark-up charged on goods supplied by Midwest and suggested that other methods of calculation may have been more appropriate, such as a weighted average.

114. Mr Young also queried whether the assessment had actually been issued since it was not exhibited in Officer Hartell's witness statement. Officer Hartell confirmed that the assessment had been raised, because the debt existed in HMRC's records against DSN and the debt would not be entered in the records unless an assessment had been raised.

115. In re-examination, Officer Hartell confirmed that she had seen previous assessments on DSN since she had reviewed them. She also confirmed that the standard practice was when an assessment was raised the taxpayer would be notified of the assessment. She confirmed that there would be no point in raising an assessment and not notifying the taxpayer of the assessment.

116. Officer Hartell also confirmed that in relation to Deal 10 (Appendix 2), DSN had not paid output tax £14,430 in relation to its sale of Intel processors to Star Express Ltd on 31 March, 2006.

117. Officer Hartell confirmed that the assessment would usually be raised taking account of all information (bank details and invoices etc) available to HMRC. On the basis of that information the assessed tax loss in respect of DSN was approximately £12.8 million. She confirmed that the output tax of £14,430 was included in the £12.8 million figure.

Our conclusions on the evidence of Officer Hartell

118. We accept Officer Hartell's evidence, subject to one issue in relation to storage facilities mentioned below, and find it as fact. In particular, we accept that DSN was a defaulting trader which failed to account for input tax in relation to Deal 10 but also in respect of other transactions. In relation to this appeal, we conclude that DSN failed to account for input tax of £14,430 in respect of Deal 10. Officer Hartell's evidence made it clear that DSN was an evasive and untrustworthy trader and that Mr Thelwell deliberately misled officers in respect of DSN's trading activities. DSN failed to keep proper records (particularly invoices of sales made by it) and which consistently failed to carry out appropriate due diligence in relation to its supply chain and eventually defaulted on substantial VAT obligations. During its VAT period 05/06 (a three month period which included Deal 10) a substantial number of DSN's transaction chains began with a defaulting trader.

119. We further conclude, on the balance of probabilities, that assessments for the missing tax were raised and notified to DSN and consider it highly improbable that they were not. We accept Officer Hartell's explanation that a debt would only exist in HMRC's records if an assessment had been raised. We also consider that those assessments were validly issued on a best judgement basis. We saw no reason why the average mark-up technique employed by Officer Hartell was unreliable. Moreover, although we disagree with Officer Hartell's conclusion that because DSN did not have storage facilities it must have on-sold goods supplied by Midwest (because the goods could have been stored with a freight forwarder), we consider that the fact that it always carried out back-to-back deals made it more probable than not that DSN did on-sell these goods. In any event, as regards Deal 10 there was an invoice to Star

Express Ltd in Deal 10 (two invoices No. 31/mar/f dated 31 March, 2006) and DSN did not account for the relevant output tax.

120. For these reasons we conclude, on the balance of probabilities, that DSN fraudulently evaded the payment of VAT and that a tax loss resulted from such evasion. There was no dispute that the deal chain in relation to Deal 10 in period 03/06 was correct and it follows, in our view, that the Appellant's purchase of the goods in Deal 10 was connected to the fraudulent evasion of VAT.

Evidence of Officer Lam – West 1 Facilities Management Limited ("West")

121. The evidence Officer Fu Sang Lam was contained in a witness statement. Officer Lam's evidence was not contested and his witness statement was admitted as evidence. Officer Lam's witness statement concerned the alleged defaulting trader West.

122. Officer Lam had worked in HMRC's MTIC team since November 2002. Officer Lam first came across West in early 2006 when dealing with one of West's main suppliers. During April and May 2006 Officer Lam was acting as Senior Officer and Manager of the Uxbridge MTIC Team.

123. West was registered for VAT in August 2000 and its main activities (on its application for registration) were described as "providing computer and software solutions and services". Its estimated annual taxable turnover was £60,000 plus in the next 12 months including £30,000 sales to the EU. The actual turnover for the next 12 months was approximately £255,000.

124. West submitted quarterly VAT returns for the quarterly periods ended 31 March, 30 June, 30 September and 31 December each year.

125. In the periods relevant to this appeal, the director of the company was Mr Ryan David Foley, who was appointed in February, 2006. Mr Foley was also appointed company secretary earlier in the same month. Mr Foley was also the principal shareholder and owned 100 ordinary shares of £1 each. The only representative of West was Nikki Patel ("Ms Patel") whom Officer Lam met during his visits to West's offices.

126. Officer Lam summarised the VAT returns rendered as follows:

VAT Period	**Outputs £**	**Tax £**	
01/02	0	487.51	Repayment to West
09/02	0	396.23	Repayment to West
12/02	0	Nil Return	

03/03	38,592	2117.89	Payment to HMCE
06/03	0	Nil Return	
09/03	0	Nil Return	
12/03	0	Nil Return	
03/04	11,009	209.09	Payment to HMCE
06/04	0	Nil Return	
09/04	10,000	387.20	Payment to HMCE
12/04	29,342	6069.89	Repayment to West
03/05	60,591	3880.60	Repayment to West
06/05	38,268	1419.00	Repayment to West
09/05	4,800	551.68	Payment to HMRC
12/05	61,883,305	5708.87	Payment to HMRC
03/06	372,943,012	164,665.15	Due to West
03/06 (corrected)	690,779,109	48,931,165.12	Due to HMRC
Final period (missing)	810,950,791		

127. Officer Lam drew attention to the very significant increase in outputs in the periods 12/05 and 03/06.

128. In October 2005 HMRC officers met West's director, Mr Michael McGrath. It was noted that West was buying and selling mobile phones and had two bank accounts: one with FCIB and one with Nat West at Deal in Kent. Mr McGrath was advised of the need to verify trading partners via the Redhill VAT office clearance procedure. It was noted that West had been using the Redhill clearance procedure, but only after the deals had been done.

129. In subsequent visits by HMRC officers to West's premises it was noted that West did not insure the goods in which it dealt, did not carry out credit checks on their trading partners and had no investors. The company traded at no risk -- payments were received from customers before suppliers were paid. West did not advertise and the director did not attend trade fairs.

130. In February and March 2006, HMRC notified West that certain of its dealings commenced with a fraud involving a tax loss in VAT quarter 12/05 (32 out of 40 deals) and the month of January 2006 (all 38 deals)

131. In August 2007 HMRC wrote to West informing them that 7 out of 193 deals in period 03/06, 40 out of 782 deals in period 06/06 (in both periods where West had acted as "broker") and 37 out of 193 deals in 03/06 (where West had acted as a "buffer") had commenced with a VAT fraud – the tax losses for these periods being £54 million, £70 million and £10 million respectively. In periods 12/05, 03/06 and 06/06 West was identified as the UK supplier of mobile phones in transaction chains to a significant number of UK traders (brokers) who were seeking large repayments of VAT. The Appellant was one such broker.

132. Between February 2006 and June 2006 HMRC officers visited West's offices on six occasions, but Mr Foley was not present. Officer Lam recounted the various efforts made to contact West by telephone and by further unannounced visits to West's offices. Mr Foley was not present. In April and twice in May 2006 HMRC wrote to West requesting details of sales invoices for verification and for written confirmation of their new address. West did not respond.

133. On 15 May 2006, West's VAT return dated 4 March, 2006 was received by HMRC and showed an overall net VAT repayment of £164,605.15. The repayment claim resulted from purchases made from UK traders for onward sale to EU customers. West did not declare any EU acquisitions on the 03/06 return submitted. Repeated requests were made to West to produce the business records for deals in period ending 03/06.

134. On 19 May, 2006, Officer Kandola telephoned Mr Foley to arrange an appointment to uplift West's business records. Mr Foley said he would be away on holiday. In a subsequent telephone call Mr Foley agreed that he would deliver West's business records to HMRC on 22 May, 2006. Some records were eventually provided on 24 May, 2006 for VAT period 03/06. These consisted only of purchase and sales invoices and release notes.

135. On 14 June, 2006 Officer Lam, together with a colleague, decided to undertake a further unannounced call to West. Contact was made with an employee of West called Nikki Patel. The deal logs for April and May 2006 was requested. Ms Patel advised the officers that the records were unavailable because they were held at Mr Foley's home in Dover. Mr Foley, she said, was in Spain.

136. During verification of the 03/06 return submitted by West, HMRC became aware that West was continuing to make EU acquisitions and had made purchases from a trader in Belgium called Capital City SPRL. It was decided to issue a Notice under Regulation 25 (1) (c) Value Added Tax Regulations 1995 which, where it is perceived that there is a significant risk to the revenue, shortens the length of a trader's VAT return and all VAT due becomes immediately payable. A Regulation 25 Notice meant that West had to complete VAT returns to a specific date.

137. The Regulation 25 Notice was served on West on 20 June, 2006. There was no one present from West to take delivery of the Notice and the officers left the Notice with the receptionist marked for the attention of Mr Foley.

138. HMRC officers visited West's offices again on 21 June, 2006 to collect the VAT return for the shortened period 06/06. They met a lady called Nikki (presumably, Ms Patel). She advised that Mr Foley was not present at the premises. She had read out the Regulation 25 Notice to Mr Foley over the telephone the previous day but Mr Foley had not completed the VAT return. Nikki telephoned Mr Foley and informed the officers that she had contacted Mr Foley who had informed her that he would be arriving at West's offices within a few hours. A VAT deregistration letter was left at West's offices with Nikki, marked the attention of Mr Foley, stating that he should contact HMRC's Uxbridge office as a matter of urgency and present records and accounts for inspection in order to review the decision. Mr Foley never contacted HMRC's Uxbridge office.

139. On 16 August 2006, HMRC sent a letter to West advising that an adjustment had been made to the VAT return for period 03/06 because West's records indicated that West had made more sales and purchases then it had declared in its VAT return. In a subsequent letter on the same day, HMRC clarified that the net tax payable by West was £48,931,165.00.

140. Eventually on 8 November, 2006 HMRC officers interviewed Mr Foley regarding his involvement with the business of West and the position regarding transactions which purportedly took place between January 2006 and June 2006. Mr Foley asked why his VAT number had been deregistered and enquired about his VAT repayment claim for 03/06. Mr Foley said that the business had changed its address. He provided some business records for deals done in April and May and June 2006. He stated he had acquired the company from Michael McGrath for £20,000, which was paid for the contacts that Mr McGrath had made. Prior to purchasing the company Mr Foley had worked at West as the company secretary in January and February 2006.

141. Mr Foley was asked how the business operated. He said that he was offered stock to buy which he then on-sold. He could not, however, name his contact with the company United Traders in Portugal, a company with which West had traded. He stated that his former employee Ms Ramal Patel knew the contact. Mr Foley confirmed that Ms Patel, his only employee, had left West's employment in June 2006. He also confirmed that his previous employment was working as a Heavy Goods Vehicle driver through an agency, but was unable to recall the name of the agency. He stated that he had done nothing since June 2006 and this was also the last period in which he had made any sales. When asked how he calculated the figures on the VAT return he stated that he added them up on a calculator. He claimed that he had submitted the 06/06 return and that it was in the post. Mr Foley was asked why the records he provided on 24 May, 2006 for January, February and March 2006 showed more transactions than were declared on the VAT return. He stated that this must be a mistake. Mr Foley was asked to provide further information including bank

statements, export and import evidence, a VAT workings, a supplier/customer list and due diligence materials. Mr Foley agreed to provide the information.

142. After the meeting had terminated, Mr Foley returned to HMRC's offices and requested that HMRC return all the business records produced at the earlier meeting. HMRC told Mr Foley that he would have to make an appointment to view the records. Mr Foley left HMRC's offices but did not arrange an appointment. Officer Lam described the verification by HMRC of West's 03/06 and 06/06 VAT returns. He noted that in those two periods West had traded in a variety of products including photo-chromatic lenses, iPods, medical dressings, mobile phones, alcoholic drinks, digital cameras and projectors, tax guide software, CPUs and other computer-related products. A number of these products were ones in which West had not previously dealt. In the period 03/06, in addition to the EU sales, West had also made substantial purchases from EU traders but had not declared them on the VAT return.

143. HMRC established that during the period 1 January, 2006 to 22 June, 2006 West had completed 557 transactions (sales). These transactions are summarised in the following paragraphs. For the period ending 03/06, the transactions were as follows:

(1) in January 2006 there were 37 transactions (sales) of which 37 involved West purchasing mobile phones from a UK-based supplier called Perrypoint Ltd for a total value of £64,672,005 and then made onward supplies to 80 traders in the UK for a total net value of £64,710,061.25. In these instances West acted as a buffer in the supply chain. All 37 transactions traced back to Puwar Ltd, a defaulting trader. Puwar Ltd had acquired the goods from Capital City. Assessments had also been raised against Puwar Ltd for all deals where supplies were made to Perrypoint that lead to West. The total value of the assessments raised was £12,365,746 issued on 25 August, 2006 and £27,473,695 issued on 19 September, 2006.

(2) No transactions were recorded in February 2006.

(3) In March 2006 there were 156 transactions of which 149 involved West acquiring mobile phones and medical dressings from an EU supplier, United Traders, for a total value of £307,530,977.66. In these instances West acted as the acquirer in the supply chain. The seven remaining transactions involved West purchasing voice minutes and phone cards from two UK-based suppliers for the combined net value of £309,174,494.07 and then selling them to two EU-based companies for a total value of £318,852,511.90. In these instances, West acted as the broker in the supply chain.

144. Officer Lam prepared a diagram summarising West's transactions in relation to the 03/06 period. In summary, this showed West playing a multiple trading role as a buffer, as the UK acquirer (importer) and finally as a broker (exporter).

145. Using the documents provided by West HMRC detected a distinct pattern of transactions within the 03/06 period of trading with 53.91% of transactions being standard rated and zero rated transactions amounting to 46.38%. Officer Lam considered this pattern was consistent with contra-trading.

146. Moreover, West's declaration on 15 May, 2006 for the period 03/06 showed net sales as £372,943,012 and net purchases of £372,383,712. On examination of the records for that period, HMRC found the net sales were actually £691,753,311 and net purchases were £681,377,476. They showed that West had under declared sales and purchases by £318,810,299 and £308,993,764 respectively.

147. As regards West's final period 06/06, West did not furnish HMRC with a VAT return. However, the business records provided by West on 8 November, 2006 showed that West was again buying from the EU and selling to the UK and in separate deals was buying from UK traders despatching to the EU. The transactions are summarised as follows:

(1) In April 2006 there were 84 transactions of which eight involved West acquiring wine from an EU-based supplier Capital City for a total net value of £252,837.33 and on-selling it to a UK purchaser for a total net value £252,837.33. In these instances West acted as the acquirer (ie the importer) in the supply chain. A total of 54 transactions involved West acquiring mobile phones and other products including iPods from an EU based supplier, United Traders, for a £121,576,034.80 and then selling them on to UK-based companies for a total net value of £124,007,081.80. In these instances West acted as the acquirer in the supply chain. A total of 22 transactions involved West purchasing CPUs from a UK-based supplier, DVV Consulting Ltd for a total value of £124,064,561.25 and then selling them to Capital City (see above) for a total net value of £130,381,492.50. In these transactions West acted as a broker in the supply chain.

(2) In May 2006 there were 93 transactions of which 12 involved West acquiring wine from Capital City for a total value of £386,214.60. West then on-sold the wine to a UK-based company for a total net value of £386,214.60. In these instances, West acted as the acquirer in the supply chain. A total of 78 transactions involved West acquiring mobile phones, software and other products including iPods from an EU based supplier, United Traders, (74 transactions) and Bon Bein Kom (4 mobile phone transactions) for a total net value of £178,316,850.00 and on selling them to UK-based companies for a total net value of £174,211,100.00. In these instances West acted as the acquirer in the supply chain. Three transactions involved West purchasing CPUs from a UK-based supplier Hyderose Leisure Ltd for a total net value of £46,284,918.75 and then selling them to, Capital City, for a total net value of £46,290,163.50.

(3) In June 2006 there were 185 transactions recorded of which 10 involved West acquiring wine from Capital City for a total net value of £316,200.12. In these instances West acted as the acquirer in the supply chain. 160 transactions involved West acquiring iPods, mobile phones, digital cameras and projectors, CPUs and other computer-related products from four EU-based suppliers for a total net value of £90,329,384.10 and then on-selling them to UK-based companies for a total net value of £103,237,855.25. 15 transactions involved West purchasing CPUs from a UK-based supplier, Hyderose, for a total net value of £231,841,575 and on selling them to Capital City for a total value of £231,867,846. In these instances, West acted as a broker in the supply chain.

148.In respect of the period 06/06, HMRC issued to West assessments totalling £126,090,717.

149. On 31 October, 2007 HMRC notified West of its decision to deny input tax in respect of the supplies of phone cards purchased from UK traders for onward sale to EU customers in the period 03/06. Similarly, input tax was also denied on supplies relating to purchases from UK traders for onward sale to EU customers in the period 06/06 in respect of CPUs. The input tax denied was as follows:

(1) input tax in respect of the period 03/06 of £54,105,536 and in the final period input tax of £70,383,434. Total = £124,488,970.

(2) For period 03/06 input tax of £24,104,831.46 and £30,000,705.00 in respect of purported purchases from ACF (deregistered) and Lodgeway (deregistered) respectively.

(3) In the final VAT period input tax of £48,672,136 and £21,711,298.2 in respect of purported purchases from Hyderose (deregistered) and DVV (deregistered) respectively.

150. Officer Lam gave details of other traders in West's deal chains. First, Capital City was compulsorily deregistered by the Belgian tax authorities on 2 February 2006 as a "missing trader". Secondly, United Traders of Portugal was registered for VAT on 14 March, 2006 and deregistered on 31 July, 2007. Between 7 March, 2006 and 31 March, 2006 United Traders sold goods to the value of £307,530,977 to West. The Portuguese tax authorities stated that United Traders shareholder and manager was a Mr Ravender Kumar Datta. United Traders had no premises and the head office address was a private home occupied by a Portuguese national who had nothing to do with the company and who had no relevant documents. The address was being used as an accommodation address.

151. Officer Lam also stated that there were concerns regarding the existence of the goods which were purported to have been traded by West, particularly, in relation to the purchase of phone cards, CPUs and alcoholic drinks from Capital City. There were regulations and requirements in relation to the transportation and storage of alcoholic drinks imported from another member state and there was no record of West having submitted an Occasional Importers application. West has provided HMRC with no evidence of imports or exports, or as regards transportation and delivery documentation in respect of the movement of goods.

152. West had not provided bank statements to demonstrate that payments had been made in respect of any sales or purchases. There was no evidence to show that payments had been made in respect of storage, freight, or general business expenses. West had not supplied information relating to due diligence checks which it carried out on its trading partners. HMRC's Redhill office had no record of any registration checks from West.

153. HMRC checked West's telephone records in respect of its principal place of business. There was no record of any calls made to West's four UK suppliers, viz Lodgeway, ACF, Hyderose and DVV. There was no record of any telephone calls

made to West's two EU customers: Capital City and Umbria. There was, however, a record of three faxes sent to Capital City on 26 May, 2006.

154. On 7 September, 2009 the Insolvency Service wrote to HMRC informing them that Mr Foley, director of West, had given an undertaking that inter-alia he would not be a director of a company. The schedule of unfit conduct attached to the disqualification undertaking stated:

> "During the period 3 April, 2006 and 21 June, 2006 Mr Ryan David Foley knowingly caused [West] to undertake a method of trading which involved it in, and put HMRC at risk of being subject to, a MTIC VAT fraud.
>
> If he did not so know, then he was reckless or grossly negligent as to whether [West] was concerned in such a fraud."

155. Officer Lam concluded:

> "Given all the above factors, I consider that the transaction chains in the period covering January 2006 to June 2006 were part of a deliberately contrived scheme carried out with the knowledge and involvement by [West]. I can see no reason why or how [West] could have become unwittingly involved with fraud on this scale. Documentation provided by (West) to HMRC and to "trading" partners has proved to be false. The transactions, in my judgement, did not occur under normal commercial conditions, but rather they were artificially contrived as part of a scheme to defraud the public revenue. To date the total value of unpaid VAT on identified transactions by [West] amounts to £126,090,717.00. I have checked the HMRC systems had established that this amount remains unpaid."

Our conclusions on the evidence of Officer Lam

156. Officer Lam's evidence was not challenged and we therefore find it as fact. In our view, on the balance of probabilities, it is clear that West fraudulently evaded VAT on a massive scale and that a tax loss arose as a result. There was clear evidence that its VAT returns were incorrect and failed to record acquisitions, purchases and supplies. The amounts of these under-declarations were so large that they cannot possibly, in our view, have been accidental. Moreover, there was a history of non-compliance in its record-keeping and its failure to supply HMRC with adequate information. There were no records of telephone calls made by West to its suppliers or its EU customers. The evidence in our view demonstrated that, on the balance of probabilities, that the wine which West purportedly traded was not imported or exported from the UK. There was no explanation how in the three periods 12/05, 03/06 and 06/06 West's turnover managed to grow by such an enormous amount. This, of itself, suggested to us that West was engaged in artificial transactions. We conclude therefore that the tax loss resulted from West’s fraudulent evasion of VAT.

Evidence of Officer Lamb – Roble Comm Limited ("Roble")

157. Officer Robert Lamb is a senior officer of HMRC and a member of the MTIC fraud team based in HMRC's Finchley office. Officer Lamb gave evidence in respect of the alleged defaulter Roble for which he was the controlling officer.

158. Roble was incorporated on 26 October, 2005 and was registered for VAT with effect from 1 October, 2005. Form VAT 1 was signed by its director Ms Ummkulthum Said and its estimated taxable turnover was £89,000 and its main business activity was declared to be "telecommunication and general trading". There was no indication of the value of goods likely to be bought or sold to or from other EU member states in the next 12 months.

159. On 20 March, 2006 HMRC officers visited the registered address of Roble. This address turned out to be that of an Internet phone cafe. The officers established that Roble was not operating from that address and that all mail was being collected. An immediate hand-written deregistration letter was left at the address.

160. On 22 March, 2006 Roble's director, Ms Said, telephoned Officer Lamb and asked him to reconsider the decision to deregister Roble. Ms Said indicated that the company had generated millions of pounds worth of sales and hundreds of invoices. Officer Lamb replied that he could not reinstate Roble without inspecting all business books and records.

161. On 24 April, 2006 Ms Said met Officer Lamb at HMRC's offices. She presented all her business books and records, with a folder for each day of trading as well as individual plastic wallets for each deal pack. Ms Said did not have bank statements with her. She explained that she had agreed that all payments on her sales invoices should be paid directly to a third-party company and for an element of commission to be paid to her direct. She said this was the only way that she could get a foothold in the industry.

162. Officer Lamb explained the issues relating to third-party payments but it appeared that Ms Said appeared unconcerned that she might not be able to pay her VAT liabilities. Ms Said presented a further folder containing deal packs relating to phone card sales involving purchases from a UK company called Lodgeway Consultants ("Lodgeway") and sales invoices to an Italian company called Umbria. Ms Said confirmed that she had no previous history or involvement in trading in these types of sales before, nor did she seek this opportunity as both customer and supplier instigated contact with her shortly before these deals took place. Ms Said promised to provide bank statements to Officer Lamb.

163. The purchase invoices provided by Roble showed that the phone cards were purchased from Lodgeway and that the net value of all purchases was £103,309,500 and VAT was charged amounting to £18,079,162.50 over a period of nine days.

164. Officers visited the premises of Lodgeway on two occasions. The first visit took place on 27 March, 2006 and Lodgeway was deregistered on that date because there was no one at the address. On the second visit on 22 November, 2006, officers spoke

to a gentleman who advised that he had lived at this (residential) address since the late 1960s and that he had never heard of Lodgeway.

165. The invoices provided by Roble also showed phone cards being sold to Umbria Equitazione ("Umbria") in Italy. The value of the sales was £103,447,246 and no VAT was charged to the Italian company. Mutual assistance information received from the Italian authorities in respect of Umbria indicated that their trade comprised the wholesale and retail of equestrian items and that they had never traded in phone cards. Moreover, according to the mutual assistance information, Umbria's trademark and telephone numbers on the invoices supplied by Roble were completely different from those used by the genuine Umbria.

166. Evidence obtained from the manufacturer of the phone cards indicated that fewer than 10,000 of the particular phone cards concerned were ever produced. Roble's invoices indicated that it had bought and sold 3.4 million phone cards over eight days of trading.

167. Roble's due diligence folder contained no supporting evidence of any meaningful checks made against companies involved in the phone cards deals, only an online VAT validation report which took place after the deals had been concluded.

168. Officer Lamb received bank statements by fax on 30 March, 2006. These showed no evidence of payments being made in or out in relation to phone card deals.

169. Apart from a CMR (a consignment note for road transport) and a ferry ticket provided in support of Roble's phone card deals, Roble's records contained no inspection reports, insurance documents, or correspondence of any type to support the £103 million worth of trade ever taking place.

170. After the meeting on 24 March 2006, Ms Said failed to return HMRC's telephone calls. Officer Lamb and a colleague visited Roble's new address on 3 April, 2006. They managed to identify additional invoices and some freight forwarder documentation which had not been previously presented by Roble. They removed the relevant paperwork.

171. The deregistration date of Roble was amended in order accurately to reflect the company's true tax liabilities and the fact that it continued to trade up to 24 March, 2006.

172. HMRC's Redhill verification office confirmed that although other UK companies have attempted to verify Roble, the majority of them have also been deregistered for VAT in March 2006.

173. HMRC have no record of receiving a return for period 03/06.

174. Roble was compulsorily wound up on 27 June, 2007. The amounts assessed on Roble were £25,195,599. The assessments have not been appealed.

Our conclusions on the evidence of Officer Lamb

175. The evidence of Officer Lamb was not challenged and we, therefore, find it as fact. We concluded, on the balance of probabilities, that Roble fraudulently evaded VAT. Roble made no attempt to account for VAT in respect of its sales or submit correct VAT returns. It made no credible attempt to carry out due diligence in respect of its trading partners. The number of phone cards which it purported to deal in exceeded the number produced. Roble's bank statements did not record the payments purported to be made in respect of its phone card deals. Its trading partner, Lodgeway, did not exist at its registered address and Umbria seemed to be using a hi-jacked VAT number. Roble has made no attempt to appeal the assessments made against it. It has left outstanding a substantial tax debt. In our view, these factors point clearly to the conclusion that Roble was a defaulting trader which fraudulently evaded VAT and that a tax loss resulted from such fraudulent evasion.

Evidence of Officer Berry – HKS Trading Limited ("HKS") (period ending 05/06)

176. Officer David Berry is a member of HMRC's MTIC team. He took over responsibility for HKS, the alleged contra-trader, on or around 19 June, 2006. He gave evidence in relation to HKS's VAT return for the three month period ending 05/06. Officer Cooper gave evidence in relation to HKS's VAT return for the three month period ending 08/06.

177. Officer Berry summarised the background as follows.

178. HKS was incorporated on 1 June 2004 and was registered for VAT with effect from 9 September 2005. At the time of registration, the director was Mr Farhan Saif and the company secretary was Mr Sajjad Khoker. Mr Saif became a director on 21/02/05 and Mr Khoker was appointed as company secretary at the same time.

179. HKS's main business activity was described on its Form VAT 1 as "selling household electrical goods e.g. MP3 players." The form also suggested that HKS was looking to expand into telecommunications and was going to target local businesses offering them contracts from Vodafone.

180. When HKS was registered for VAT neither the director nor the company secretary appeared to have any other active business interests, but this was to change. Mr Saif's wife later became the company secretary.

181. In 2002 Mr Saif was convicted of robbery and received a six year custodial sentence. The report exhibited by Officer Berry indicated that Mr Saif used an alias-Farhan Khan and an alternative date of birth (17/10/1981).

182. HKS first started trading in wholesale mobile phones in February 2006.

183. HKS was deregistered for VAT purposes on 26/07/07. The officers of the company had changed and the director had failed to respond to letters and telephone calls from HMRC.

184. HKS submitted quarterly VAT returns for the three month periods to the end of February, May, August and November. The VAT return for the period 05/06 was received by HMRC on 24 July, 2006. This return was selected for what HMRC describe as "extended verification" i.e. detailed scrutiny.

185. HKS submitted four quarterly VAT returns. The figures for the four quarters were as follows:

Period	**02/06**	**05/06**	**08/06**	**11/06**
Output Tax	£9,576,025.25	£36,176,034.35	£3,673,488.16	£43,337.00
Acquisition tax	Nil	Nil	Nil	Nil
Output Tax	£9,576,025.25	£36,176,034.35	£3,673,488.16	£43,337.00
Input Tax	£9,570,005.08	£36,522,374.71	£3,671,924.27	£44,111.73
Net Tax	£6021.17	£346,340.36cr	£1,563.89	£774,73cr
Outputs	£60,532,250	£206,720,196	£20,991,361	£247,640
Inputs	£60,433,650	£208,698,428	£20,982,424	£252,072
EC Supplies	£Nil	£2,115,000	£8,457,338	£Nil
EC	£5,752,000	£17,714,393	£8,431,630	£Nil

186. In the period 05/06 HKS's output tax and input tax very nearly balanced, with only a £346,340.36 excess of input tax over output tax, where both input and output tax both totalled over £36 million: a strange result, in our view, on a turnover in excess of £200 million.

187. Officer Berry analysed the transactions that HKS entered into in the 05/06 period and produced the following table:

Transaction Types	**Number of Transactions**	**Value of Transactions (HKS Input tax)**	**Total amount (net)**
Acquisitions	35	£4,841,600.19	£27,666,286.80
Broker deals	6	£3,475,251.50	£19,858,580
Buffer deals	29*	£33,045,125.95	£188,829,291.14

* This appears to be inconsistent with the number of buffer deals (28) recorded by Officer Berry in relation to the Table reproduced in paragraph 192 below and we assume that the correct figure for buffer deals is 28.

188. Officer Berry had traced all the transaction chains in question. He explained that the table analysed the type of deals that HKS had entered into for that period. In the acquisition deals, HKS had acquired goods from the EU, in broker deals it dispatched

the goods from the UK to an EU or overseas customer and in buffer deals it purchased from a UK trader and sold the goods to a UK trader. The 35 "acquisition deals" included the nine contra-trade chains in March 2006 (excluding the chain concerning DSN – Deal 10) which are the subject of this appeal.

189. Officer Berry analysed the time when the different types of deals were done in the three month 05/06 period and produced the following table:

	March	**April**	**May**	**Total**
Acquisition	13	13	9	35
Buffer	12	5	11	28
Broker	1	0	5	6
Total	26	18	25	

190. Thus, the majority of the EC acquisition deals occurred in March and April (with only one broker a deal occurring in those months). As regards March, nine of the 13 deals related to this appeal. The acquisition and buffer deals were reasonably spread out over the three-month period. The broker deals were, however, weighted towards the end of the period (the broker deal in March involved the defaulter Roble). In Officer Berry's view, HKS was building up a large amount of input tax at the end of the period to offset against output tax incurred earlier in the period. There were far fewer broker deals than acquisition deals and consequently the values involved in the broker deals were much higher. His evidence was that it was not unusual to see a flurry of activity by a contra-trader at the end of a VAT period in order to reduce any outstanding VAT liability on outputs made earlier in the period.

191. As regards the 35 acquisition deals in the period 05/06, there were four suppliers based in the EU. Most of the supplies to HKS were made by two companies: EURL Corinth (“Corinth”) (a company based in France) and World Tagus (a company based in Portugal). Officer Berry analysed the deals as follows:

Trader	**March**	**April**	**May**	**Total**
EURL Corinth (FR)	12	12	0	24
World Tagus (PT)	0	1	8	9
Megatek SARL (FR)	1	0	0	1
Magic Phone SL (ES)	0	0	1	1

192. In the three month period to May 2006 there were six tax loss deal chains (of which five took place in May) all of which traced back to tax losses caused by a fraudulent evasion by defaulting traders. There were two defaulters in that period: Roble, in respect of one chain, and West in respect of the others. (See the evidence of Officers Lam and Lamb above) In each chain HKS acted as broker exporting the

goods to two Turkish registered companies (Zi Enterprises, in four cases, and Saphire Industries ("Saphire") on one case) and in one case to a polish company, Skala Handel Spolka.

193. Officer Berry provided details of the defaulting traders as follows:

Defaulter Name	Number of deals	Tax loss	When assessed & period covered	Assessing Officer
Roble	1	£164,348.80	Assessed 10/05/06. Period Ref 03/06	Rob Lamb
West	5	£3,150,087.50	Assessed 18/10/06. Period Ref 99/99[06/06]	Rupinder Kandola

194. In other words, according to Officer Berry, as regards five HKS broker deals, those deals traced back to tax losses of £3,310,387.50 attributable to West. As regards one HKS broker deal, the deal traced back to a tax loss of £164,864 attributable to Roble.

195. If the six broker deals undertaken by HKS in the three-month period ending 05/06 were ignored, HKS would have had a liability to HMRC of £3,128,911.14 (instead of a repayment of some £346,000).

196. Officer Berry referred to the six broker deals which HKS carried out in its 05/06 period. It had previously been HMRC's practice to attribute tax losses incurred as a result of defaulting traders such as West and Roble to brokers in the contra chain i.e. to ensure that there were enough fraudulent tax losses in the "dirty chains "to cover input tax claimed by brokers in the "clean chains". Officer Berry confirmed that it was no longer HMRC's practice to carry out this attribution.

197. Mr Young, in cross examination, challenged the basis of attribution of tax losses to the Appellant, arguing that there was no clear rationale for the manner in which tax losses of defaulting traders were allocated amongst brokers including the Appellant. Officer Berry accepted that there was no evidence demonstrating how the allocation actually occurred in practice in this case. Officer Berry's evidence was that there were enough tax losses in HKS's deal chains to cover all the input tax that HMRC was seeking to deny in respect of input refund claims by broker traders. At the time Officer Berry's witness statement was drafted it was HMRC's practice to allocate such losses amongst the brokers, but, as explained above, HMRC no longer did so, with the result that there was no such allocation.

198. Apart from the Appellant, the other brokers used by HKS in the contra chains were Textmart Ltd, Matrix Europe Ltd (of which Mr Khan, one of the Appellant's directors and shareholders, was a director), Ex-More Ltd and Veyron Ltd.

199. As regards the buffer deals undertaken by HKS, according to Officer Berry, 2 deals traced back to a defaulter, Zoom Productions Ltd, and 26 traced back to West.

200. Officer Berry gave examples of three deals involving HKS acting as broker. The first deal involved Roble as the defaulting trader (see Deal 7 Appendix 4). Officer Berry drew attention to the fact that all the entities involved banked with FCIB. He also noted that there appeared to have been no inspection of the goods carried out by or on behalf of HKS. The software concerned was not covered by insurance. The transactions in the chain took place on the same day. There was almost no export evidence in relation to the goods.

201. The second example concerned the defaulting trader West (see deal C 19 - 194 Appendix 4). Officer Berry considered this to be representative of other broker deals in which HKS was involved. The commodities were the same (except in one deal), and the same UK parties were involved in the same position in each of the deal chains. The freight forwarder was the same, all parties banked with FCIB and there was no insurance. No inspection of the goods carried out. No shipping documents were provided by HKS. The size of the deal concerned Officer Berry. A large amount of software was being traded in identical chains and was all destined for Turkey. The deal, as with other defaulter deals, was completed according to the invoices on the same day. This transaction was very similar to another transaction (see deal C 19 - 193).

202. Finally, Officer Berry referred to a third broker deal undertaken by HKS (deal 14 Appendix 4). Officer Berry noted that the goods concerned had been released by HKS to the customer before HKS had been paid and, indeed, before HKS had paid its supplier. In this case, however, an inspection report was requested. It was unclear whether the goods had been insured.

203. Officer Berry gave details of visits made by HMRC to HKS on 18 November 2005 (at which trading in the MTIC industry and the risks associated with third-party payments were discussed). Mr Saif said he had decided to trade in the specified commodities and take the risk.

204. HKS was visited by HMRC on 6 April, 2006 and 3 May, 2006. HMRC officers discussed with Mr Saif the fact that no inspection reports or unique reference numbers in respect of the goods were obtained. Mr Saif informed them that there were no loans or investors and customers paid for goods before HKS paid its suppliers). Officer Berry and a colleague visited HKS on 8 August, 2006. Officer Berry noted that HKS contradicted some information previously provided to other HMRC officers e.g. that the trader now stated that it would trade in any goods (not just mobile phones and software), that credit terms were offered to customers (even though it had previously been stated that payment was taken from customers to fund purchases) and that HKS had made one third party payment, having previously stated that it would make none.

205. Officer Berry stated that there were a number of factors which in his view indicated that the transactions in which HKS was involved were contrived. First, HKS's turnover had increased to a very large amount from a "standing start". He produced the following information:

Period	Net Outputs	Output Tax
11/05	£ nil	£ nil
02/06	£60,532,250	£9,576,026.25
05/06	£206,720,196	£36,176,034.35
08/06	£ 20,991,361*	£3,673,488.16*

*Corrected in response to a question from the Tribunal.

206. Moreover, the input and output tax figures for HKS matched very closely (see the table at paragraph 1 to 4 above) and suggested contra-trading activity. It was rare in Officer Berry's experience that a trader managed to match its output and input tax almost identically, period after period, regardless of volume, type, or price of commodity.

207. Officer Berry also produced figures comparing the tax losses at the start of HKS's tax loss chains (where HKS acted as broker) and the repayments claimed by brokers where HKS acquired goods. These figures (disregarding the VAT repayment) were remarkably similar with a difference of £152,601.81 on a turnover of over £206 million:

Month	O/T Due from Defaulter in HKS Broker Chains	I/T claimed by Broker in HKS Acquisition Chains
March	£164,348.80	£1,806,302.94
April	£0	£972,726.18
May	£3,461,412.46	£348,329.92
Total	**£3,625,761.26**	**£3,127,359.04**
Difference	£498,402.22 - £346,340.36 (repayment for period)	
Final Difference	**£152,601.81**	

208. When HKS applied for registration, Form VAT 1 stated that the expected turnover for the company's first year would not exceed £150,000 and it would neither import or export goods. These statements were clearly untrue since they were contradicted shortly after the commencement of trade. Indeed, the earliest invoice provided to HMRC by HKS for the 02/06 period had a net value of £1.6 million.

209. HKS submitted no returns for 02/07 and 05/07 and at the time of Officer Berry's witness statement (24 March, 2010) there were outstanding unpaid assessments of £1512 and £1468.

210. As regards pattern of trading, there were a number of aspects that pointed towards HKS's deals being contrived.

211. First, Officer Berry pointed out that 55% of the total deals for the 05/06 period were carried out in the last 10 days of the three months. Five of the six broker deals were entered into in the last 10 days of May. This had the effect of reducing HKS's tax liability for the period (in fact it reduced so much that it reversed the position into a repayment position). In addition, HKS traded commodities that were generally associated with MTIC trade, such as mobile phones, iPods and CPUs. HKS had been requested by a letter dated 30 November, 2006 to provide information in respect of the goods traded but no response was received.

212. Secondly, all the software traded by HKS in the 05/06 period was exported by it to Turkey (Zi Enterprises and Saphire Industries). Although the invoices suggest that two different companies acquired the goods, the invoices are identical in layout and the fax numbers were identical.

213. Thirdly, Officer Berry noted the similarity in the mark-ups achieved by HKS. As regards four of the deals in which HKS exported goods to Turkey (see Appendix 4) HKS made a mark-up of 40p. As regards the deal relating to iPods (Deal 4 Appendix 4), HKS made a large mark-up (which Officer Berry considered unrealistic) of £53 .75 per unit resulting in a profit of £322,500. We agree that this mark-up on the i-Pod deal looks unrealistic.

214. Fourthly, as regards the deals where HKS exported to Zi Enterprises (where the defaulter was West) all the parties in the chain are identical. There was no evidence of negotiation conducted by HKS with other parties. When HKS exported to Saphire (also based in Turkey and apparently associated with Zi Enterprises) the same companies appeared in the chain (with the exception of Worldwide Wholesalers Ltd).

215. Fifthly, Officer Berry noted there was a general lack of inspection reports in respect of all of the deals entered into by HKS (with the exception of the iPod deal (Deal 14 Appendix 4). HKS appeared willing to deal in goods with the value of millions of pounds that were never seen or inspected.

216. Sixthly, it was noted that HKS and all the other traders (excluding the Appellant) in the 70 deals for the 05/06 period banked with FCIB. This was a pattern regularly seen with traders who are dealing in MTIC commodities.

217. Finally, Officer Berry noted that HKS had not submitted evidence of any extended negotiations for any deals into which they entered during the 05/06 period.

218. Details were given by Officer Berry of some of the other companies involved in HKS's deal chains.

219. *Corinth (France):* this company was deregistered by the French tax authorities on 11 January, 2007 due to suspect trading patterns. The French authorities declared the company as "a non-compliant company". The business submitted no VAT returns or deal information. The sole director of the company resided in the UK.

220. *World Tagus (Portugal):* information from the Portuguese authorities indicated that the company was a non-declaring conduit company. The company was still trading. The sole partner (which we understood to mean the sole proprietor) of the business resided in Ilford, Essex and the goods which were supplied to HKS were brought from Dubai and Spain, but never entered Portugal.

221. *International Investment Services (UK) Ltd ("IIS"):* IIS was registered to VAT on 25 October, 2005. Form VAT 1 was signed by a Mr Daniel Keenan. The main business activity was declared to be "Brokering European Licensing & Distribution Trade Agreements". IIS were provided with what is called a Redhill letter ("Redhill letter") which warned them about the risks involved in trading in certain goods and advising them to contact HMRC's Redhill offers to clear VAT numbers of businesses with whom they were looking to trade prior to doing so.

222. At a subsequent visit by HMRC, it was stated that the company was dealing in computer components and mobile phones. The business was funded with only £95,000 of personal investment. There were various subsequent requests made by HMRC for the provision of records.

223. IIS was subsequently deregistered VAT on 10 August, 2007. On 18 April, 2008 a letter was issued to IIS notifying them of the decision to disallow input tax in the amount of £206,233 relating to the period 04/06 and £192,711 to the period 07/06.

224. One of the directors of IIS, Mr Daniel Keenan, had been sentenced to 5 years in prison for conspiracy to defraud and blackmail.

225. *Worldwide Wholesalers Ltd:* Worldwide Wholesalers was registered for VAT with effect from 1 November, 2005. Form VAT 1 stated that its main business activity was "wholesale furniture, household goods, and ironmongery, textiles, clothing, footwear and leather goods." The form was signed by the company secretary, Mr Wiqas Ahmed.

226. On 16 May, 2006, Worldwide Wholesalers received a Redhill letter.

227. On 10 November, 2006 HMRC wrote to Worldwide Wholesalers advising it of the intention to deregister the business due to lack of intention to trade.

228. On 1 March 2007 and 19 March, 2007 HMRC wrote letters to Worldwide Wholesalers to request an immediate payment of outstanding VAT amounts. The assessments were never appealed. The assessments were raised for under-declared output tax, as a result of information that came to light.

229. *Skala Handel Spolska (Poland):* the business was registered with effect from 31 December, 2005 and was subsequently deregistered with effect from 31 May, 2006.

Information received from the Polish authorities indicated that the main business activity was declared to be the wholesale of electronic devices, such as computers mobile phones and satellite navigation devices. The Polish authorities found that the company had no staff and had vacated their place of business leaving no forwarding address and they were therefore subsequently deregistered.

230. *Zi Enterprises and Saphire Industries:* As already noted, invoices submitted by the two companies were almost identical in layout. The fax number is the same and the telephone number was only one digit different.

231. Mr Saif, the HKS director at the time of the submission of the 05/06 VAT return, called Officer Berry on 1 February, 2007 and advised him that he was no longer the director of HKS. He asked if he could get his VAT repayment back and was advised that there would be no repayment and that, in any event, it was due to the company and not to him individually.

232. Officer Berry and Officer Cooper had a meeting with Mr Asif Hussain, the new director, and it emerged that Mr Hussain had taken control of the company from a Mr Ullah, who had himself taken control from Mr Saif only two weeks before. Mr Hussain did not know that the company had belonged to Mr Saif or that there was a claim for a VAT repayment pending. Mr Hussain had not agreed a price for the purchase of the company from Mr Ullah but was expecting to pay between £20,000 and £30,000. As Officer Berry pointed out, it was hard to see the logic behind selling a company that had a repayment pending of £346,000 for as little as £20,000 to £30,000.

233. Officer Berry reviewed the due diligence carried out by HKS on its customers and suppliers. As regards suppliers in default chains, Worldwide Wholesalers, the due diligence materials supplied to HMRC provided little detail. The introductory pack was generic and was not personalised to HKS. HKS had not requested Redhill clearances prior to trading with Worldwide Wholesalers. It appeared that no background or financial checks had been carried out.

234. In relation to due diligence performed on The Wireless Warehouse it was, in Officer Berry's words very generic. Some of the information was contradictory. A Redhill clearance was carried out on Wireless Warehouse some two months prior to the deal taking place.

235. As regards customers, minimal due diligence was carried out on Saphire. The materials supplied to Officer Berry comprised only a letter of introduction, simple business details and two Turkish documents. HKS carried out no personal or trade checks on the directors or the business, no financial checks and did not visit the company.

236. No due diligence materials were provided for Zi Enterprises.

237. As regards the Polish customer, Skala Handel, the due diligence pack appeared to be dated May 2006 i.e. 2 1/2 months after HKS sold goods to them, rendering the due diligence pack useless in respect of the earlier deals.

238. As regards HKS's EC suppliers, the information supplied as regards Corinth was minimal and only contained the business details of Corinth. In relation to World Tagus, again the due diligence materials submitted contained little detail and no additional checks were made on the supplier.

239. In cross-examination, Officer Berry was asked when he first became aware of the concept of contra-trading. Officer Berry was not sure of the exact date but thought it was when he joined the HMRC MTIC team in September 2005. Officer Berry accepted that HMRC had not published any public notice or written guidelines concerning contra-trading or the hallmarks of contra-trading.

240. Officer Berry also accepted that there was no evidence that the Appellant knew of Mr Saif's criminal conviction for robbery.

Our conclusions on the evidence of Officer Berry - HKS

241. In our view Officer Berry was a credible and reliable witness. In cross-examination, Mr Young pointed out a number of errors and inconsistencies in Officer Berry's lengthy witness statement. Officer Berry was, however, prepared to accept occasions where he had made mistakes or where assertions he made were not supported by written evidence. This did not, however, in our view undermine the reliability of his evidence as a whole. We accept his evidence and find it as fact.

242. We note, in particular, the fact that when Officer Berry first prepared his witness statement it was the practice of HMRC to attribute tax losses caused by defaulting traders to brokers and, as Officer Berry stated, that this approach has since been abandoned by HMRC. This did not, in our view, weaken Officer Berry's evidence. Mr Young's cross-examination exposed the difficulties with such apportionment and we consider that HMRC were correct in abandoning the apportionment approach. We do not believe such apportionment is necessary and is not required by the *Mobilx* test.

243. We conclude that in the period 05/06 HKS acted as a contra-trader for the purpose of fraudulently evading VAT .The contra chain deals which form the subject matter of this appeal, in our view, thus form part of an overall scheme to defraud HMRC. We reach this conclusion on the basis that, in our view, HKS carefully arranged its transactions so that its inputs and outputs for the period largely balanced, that the pattern of trading in the months to March, April and May 2006 (i.e. the timing of acquisition and broker deals) appeared to us to be plainly contrived and intended to conceal HKS's position as broker in relation to the dirty chains. Moreover, it seemed to us improbable that HKS could have built up such a massive turnover in the period (compared with its turnover in previous periods) by legitimate means. This is particularly the case when viewed in the light of the statements made in Form VAT 1, which were plainly untrue. HKS's broker deals in the three month period ending 05/06 traced back to tax losses (see Appendix 4) which arose from the fraudulent evasion of VAT, as discussed above. On the other hand HKS's acquisition deals (Appendix 4) did not contain defaulting traders or a tax loss. This contrast between the broker deals and the acquisition deals was hardly coincidental and we agree with Officer Berry's conclusions in this respect. We note the minimal due diligence performed by HKS on its trading partners. We also note that the director of the

company, Mr Saif, had a previous conviction for a serious offence involving dishonesty and violence. In our view, when the evidence painstakingly assembled by Officer Berry is viewed in the round, that evidence is compelling and the conclusion, on the balance of probabilities, that HKS in both the "clean" and "dirty" chains was entering into transactions for the purpose of fraudulently evading VAT in the period 05/06 is inescapable.

244. HKS was involved in all the deal chains (with the exception of Deal 10) in which the Appellant participated in the period ending 03/06. The Appellant did not dispute the accuracy of the deal chains put forward by HMRC. Accordingly, it follows from our conclusion in the preceding paragraph that all the deals concluded by the Appellant in 03/06 (with the exception of Deal 10, which we have dealt with separately, were connected with the fraudulent evasion of VAT by HKS.

The evidence of Officer Cooper – HKS (period ending 08/06) and Hits & Clicks Limited ("H&C")

(a) HKS

245. Officer Emma Cooper has worked in HMRC's MTIC team since April 2005. She gave evidence in relation to HKS's three-month VAT period 08/06. She also gave evidence in relation to the alleged defaulting trader Hits & Clicks Limited.

246. Officer Cooper's main contact at HKS was its director Mr Farhan Saif, who featured in Officer Berry's evidence. Officer Cooper also gave evidence in respect of Mr Saif's conviction and six years sentence of imprisonment for robbery. In addition, Officer Cooper discovered that Mr Saif had apparently been appointed company secretary for HKS in February 2005 whilst he was still in prison (he was released in April 2005 after serving just less than three years).

247. HKS was run from rented accommodation situated on a trading estate in Maidenhead, Berkshire.

248. On 16 November 2005 Mr Saif telephoned Officer Cooper to discuss why the Redhill Verification unit were not clearing HKS. Mr Saif was told that no evidence of intention to trade had been provided, and therefore HKS could not be cleared. Mr Saif was also advised that due to the products HKS intended to trade in, checks were necessary to ensure that the transactions were not fraudulent. Mr Saif went on to say that he did not care about MTIC fraud as he would continue to deal in phones and computer chips. Officer Cooper explained to Mr Saif that evidence was required to demonstrate his intention to trade before HKS could be cleared. Mr Young challenged Officer Cooper in cross-examination as to whether Mr Saif had indeed said that he did not care about MTIC fraud, suggesting that this was an extraordinary thing for him to say. Officer Cooper confirmed that Mr Saif had indeed said that: it was the only time she had ever been told that and it stayed in her mind.

249. HKS submitted the 08/06 VAT return which showed that a payment of £1563.89 was due to HMRC. This amount was paid by HKS on 20 November 2006. An extended verification of this return was undertaken by Officer Cooper which

resulted in HKS being denied input tax of £1,478,561.77 because it was alleged that HKS knew or should have known that it was a participant in MTIC VAT fraud.

250. In the VAT period 08/06 (June, July and August) HKS undertook a total of 33 deals. These deals only took place during June and August. No deals were undertaken in July.

251. In June 2006 HKS undertook 23 deals acting either as an acquirer (14 deals) or a buffer (9 deals). All the acquisition deals took place between 1 June 2006 and 12 June 2006. The goods were acquired from either World Tagus Trading or Nordic Telecommunications APS ("Nordic"). In relation to goods acquired from World Tagus Trading, in five deal chains HKS sold the goods to Churchill which then on-sold to the Appellant (Appendix 3). The parties were the same in all five deal chains. The per unit profit mark-ups were the same in each deal chain (£0.25 for HKS and £0.20 for Churchill).

252. Nordic was a Danish company. Officer Cooper made some enquiries into Nordic. Its main business activity consisted of the sale of mobile phones and perfume. The company had been incorporated in April 2005 and was de-registered in September 2006. The company was run by Mr Andrew Salami, who was based in Bolton in the UK. The premises were managed offices with no storage facilities.

253. As regards August 2006 HKS undertook 11 deals and acted as broker in all of them. All 11 deals show the goods being purchased from the same supplier, Hits and Clicks ("H&C") and were sold (exported) by HKS to Nordic. H&C was a defaulting trader. All the broker deals of HKS took place between 9 August 2006 and 17 August 2006 - a nine-day period. Nordic appeared in some June deal chains as a supplier to HKS but in August it appeared as a customer of HKS.

254. In the extended verification process for the VAT period 08/06, Officer Cooper found that the 11 deals where HKS acquired from H&C resulted in a tax loss totalling £1,478,561.77. The net value of the acquisition deals undertaken in 08/06 amounted to £8,449,360.90 and the value of broker deals for 08/06 amounted to £8,457,338.05.

255. Officer Cooper made enquiries to discover whether H&C was the acquirer (importer) of the goods. HKS had not provided her with any evidence to support the purported EU acquisitions or export sales. A visit was undertaken by HMRC officers to the freight agent, Karn Logistics ("Karn"), which moved and stored the goods involved in these deals. Karn advised the HMRC officers that it had not undertaken any deals. No freight had ever passed through Karn. Officer Cooper was unable to obtain any paperwork to suggest the goods were either brought into the UK or even exported from the UK. There was no evidence to confirm that H&C was the acquirer of the goods.

256. When Karn applied for VAT registration it supplied two letters as evidence of its intention to trade. Both letters (one from Mile Logistics limited and the other from Lead Logistics Ltd) had offered Karn contracts on condition that it registered for VAT.

257. Officer Cooper made enquiries into the acquisition deals where Nordic was the EU supplier (in the other acquisition deals World Tagus Trading was the EU supplier). There were 10 acquisition deals where HKS on-sold to K & M Supplies, a company based in the UK. The freight agent in these deals was also Karn. Consequently, Cooper was unable to find evidence of goods being imported or exported in those 10 acquisition deals. In cross-examination, Mr Young suggested to Officer Cooper that the absence of paperwork evidencing the fact that the goods have been exported could have been as a result of "triangulation" e.g. a trader based in the UK might buy goods located in Paris and have them delivered to its customer in Lisbon. Officer Cooper confirmed that there was nothing wrong with triangulation in the normal course of trading. It seemed to us, however, highly unlikely that triangulation would have happened in all 10 deals.

258. Officer Cooper performed an analysis of the deal values in the period 08/06. During this period the value of deals where HKS acquired goods totalled £8,449,360 and the value of deals where HKS exported goods out of the UK totalled £8,457,338. The difference between the value of the acquisition and export deals was £7978. This meant that the tax losses at the start of the tax loss chains were virtually equal to the repayments claimed by the brokers at the end of the acquisition deals. The difference was only £321.42. This was illustrated in a Table produced by Officer Cooper as follows

Deal	**Output tax due from defaulter (Hits and Clicks)**	**Deal**	**Input tax reclaimed by broker****
August 1	£147,885.92	June 1	£148,032.66
August 2	£132,921.60	June 2	£147,347.20
August 3	£140,040.80	June 3 **("Deal 1")***	£22,430.63
August 4	£115,565.80	June 4 **("Deals 2 & 2 A")***	£105,539.88
August 5	£135,560.46	June 5	£134,213.63
August 6	£131,714.10	June 6	£39,948.13
August 7	£137,258.80	June 7	£129,539.38
August 8	£130,760.32	June 8	£142,844.80
August 9	£146,232.57	June 9	£144,732.00
August 10	£123,603.46	June 10	£22,338.75

August 11	£137,014.94	June 11	£123,340.00
		June 12	£156,254.88
		June 13	£137,523.75
		June 14 **("Deals 3 & 3 A")***	£24,797.50
	Total £1,478,561.77		**Total £1,478,883.19**
Difference = £321.42			

*See Appendix 3

**Where HKS acts as acquirer (importer)

259. Officer Cooper performed an analysis of the profit and mark-ups where HKS acted as broker (see Appendix 3) in the period 08/06:

5

Product	**Purchase Price**	**Sale Price**	**Profit**	**Mark-up**
SanDisk 8gb	£232.16	£232.39	£0.23	0.09
Sony MS 4gb	£73.60	£73.67	£0.07	0.09
Sony MVE 4gb	£72.29	£72.36	£0.07	0.09
Courier 4gb USB	£68.08	£68.15	£0.07	0.10
Lexmark Flash Memory 64mb	£197.61	£197.81	£0.20	0.10
Cisco 3800 256mb	£298.08	£298.38	£0.30	0.10
Lexmark Flash Memory 64mb	£238.40	£238.64	£0.24	0.10
Kingston Elite Pro	£145.37	£145.52	£0.15	0.10
Xerox Flash Memory 8mb	£134.02	£134.15	£0.13	0.09
Kingston Elite Pro	£145.63	£145.78	£0.15	0.10
Lexar Compact Flash	£164.83	£164.99	£0.16	0.09

260. Officer Cooper then contrasted those figures with the equivalent figures in the deal chains where HKS acted as the acquirer (importer) in the same 06/08 VAT period:

Product	**Purchase price**	**Sale price**	**Profit**	**Mark-up**
CF Bluetooth Card	£56.66	£56.81	£0.15	0.26
CF Bluetooth Card	£47.69	£47.84	£0.15	0.31
Intel 630***(Deal 1)**	£85.00	£85.25	£0.25	0.29
Pentax Pocket Jet	£172.16	£172.31	£ .015	0.08
Bluetooth SDIO Kit	£56.66	£56.81	£0.15	0.26
Intel 640***(Deal 2)**	£99.20	£99.45	£0.25	0.25
Intel 630***(Deal 2A)**	£85.30	£85.55	£0.25	0.29
Transcend Flashcard	£50.90	£51.05	£0.15	0.29
Pretec 8gb Cheetah 80x	£127.39	£127.54	£0.15	0.11
Pentax Pocket Jet	£172.15	£172.30	£0.15	0.08
Intel 630***(Deal 3)**	£84.65	£84.90	£0.25	0.29
US Modular 4gb secure digital card	£35.09	£35.24	£0.15	0.42
Brother Bluetooth M Print	£183.95	£184.10	£0.15	0.08
Buslink 4gb USB	£120.75	£120.90	£0.15	0.12
Intel 640	£99.45	£99.70	£0.25	0.25
Intel 630***(Deal 3A)**	£83.15	£83.40	£0.25	0.30

*See Appendix 3

261. Finally, Officer Cooper set out the profits and mark-ups in relation to those deals where HKS acted as a buffer in the VAT quarter 08/06:

Product	**Purchase price**	**Sale price**	**Profit**	**Mark-up**
Nokia 8800	£407.50	£407.75	£0.25	0.06
Nokia N 80	£329.75	£330.00	£0.25	0.07

Nokia 8800	£379.75	£380.00	£0.25	0.06

262. Analysing these three tables, the mark-up depended not on the goods sold (as one would expect) but on whether the deal was an acquisition, broker or buffer deal. The mark-up was at its lowest on UK to UK buffer deals and at its highest when goods were brokered (i.e. exported) to a non-UK purchaser. Mr Young, in cross-examination suggested that it might be expected that a lower margin may be made in domestic rates rather than in export deals. Whilst we consider this to be a valid point, we consider that the profit made by the Appellant when compared with other members of the deal chains was disproportionate, even when allowing for the additional margin which would be expected for an exporter – the Appellant's share of the total profit in the deal chains was 83.54%.

263. It will be noted that in those deals where HKS acted as acquirer (the second of the three tables above) in each of the deals related to this appeal HKS made a fixed profit of £0.25 per item in each case.

264. The deal chains never traced back to a manufacturer or authorised distributor of the goods. Also, in almost all the deals, the transactions were carried out on the same day (except in two cases), back-to-back. In each deal the acquirer happened to hold the exact quantity of stock required by the customer. In several chains the participants appeared in the same order. No freight paperwork was available from HKS as evidence that the goods were ever in their possession and, as noted, Karn, the purported freight forwarder, denied being involved in these transactions.

265. HKS failed to supply Officer Cooper with any evidence that inspections were undertaken on the goods e.g. to ensure that the quantity and specification of the goods was as agreed and that the goods were not damaged. Mr Saif informed Officer Cooper orally that he inspected goods but there was no documentary evidence that he did so.

266. HKS's website advertised mobile phone contracts but there was no mention of wholesale mobile phones.

267. On 3 May, 2006, Officer Cooper and a colleague visited HKS's offices in order to collect outstanding paperwork for VAT period 02/06. In the course of that meeting, Mr Saif promised to provide Officer Cooper with details relating to HKS's bank account with Barclays bank, but this information was never provided. Mr Saif confirmed that the business had no bank loans or investors. The business was financed by HKS paying its supplier once it had been paid by its customer. HKS released goods before payment was received, although with regard to software training packages, activation codes were not provided until payment was received. Officer Cooper was informed that the goods could not be used without activation codes.

268. Mr Saif stated that he was looking into insuring goods but that he had not done so yet. He noted that the software did not have any value as activation codes were required to enable it to work.

269. At a further meeting at HKS's offices on 6 June, 2006, Officer Cooper asked Mr Saif to provide her with business records for March 2006. However, Mr Saif advised her that the records were being held by his accountant. When requested to provide his deal log for March 2006, he replied that the accountant had not completed his work.

270. Mr Saif was asked in correspondence with HMRC to provide evidence of due diligence carried out on his trading partners. Mr Saif assured Officer Cooper that due diligence checks were made on customers and suppliers of HKS, but Mr Saif failed to provide any evidence to support his statement.

271. Officer Cooper confirmed that the Appellant appeared as a broker in five of HKS's acquisition deal chains in June 2006. The Appellant reclaimed input tax totalling £87,176.26 on goods which were supplied to them by Churchill. These goods were then sold on by the Appellant to E-Future (a company based in Dubai) and therefore no output tax was charged.

(b) Hits & Clicks Limited

272. Officer Cooper also gave evidence about the alleged defaulting trader H &C (see Appendix 5). H&C was the alleged defaulting trader for the period 06/06. H&C was incorporated on 11 July, 2005 and registered for VAT on 1 March, 2006.

273. The applicant for registration was a Mr Paul Spooner from Cheshire. The estimated turnover was £120,000, although Officer Cooper stated that HMRC's evidence indicated that H&C undertook a minimum of 9,927,486.17 of gross sales. The main business activity stated on Form VAT 1 was internet marketing/other computer related activities. There was no evidence to demonstrate that H&C undertook internet marketing although there was evidence which demonstrated that H&C sold computer related products.

274. H&C submitted quarterly VAT returns. The returns were as follows:

VAT period	**Declared sales**	**Amount due to HMRC**
03/06	£7, 926	Net due £92.14
06/06	£4, 425	Net due £161 .96
09/06	Missing return	Manual assessment £158.00
12/06	Missing return	Manual assessment £1,478,121.00
Final	Missing return	Manual assessment £364,539.00

275. The VAT period 09/06 was the relevant period for this appeal.

276. Information from Companies House showed that the registered address of H&C was at Romford Road, London E 12. It also showed that Mr Shah Nawaz was

appointed a director on 9 May 2006 but that he resigned on 1 August, 2006, eight days before the date of the first transaction. Mr Nawaz did not inform HMRC of his resignation.

277. Officer Cooper was unable to meet Mr Nawaz or speak to him on the telephone. She received no response to correspondence sent to the principal place of business of H&C and to his home address.

278. Information from Companies House showed that there was no appointed director of H&C at the time of the purported transactions (Appendix 5). It also showed that Mr Nawaz resigned as a director of H&C on 1 August, 2006 but was reappointed as a director on 18 August, 2007.

279. On 9 August, 2006, eight days after Mr Nawaz had resigned, H&C sold SanDisk memory cards to HKS (see Appendix 5).

280. On 24 January, 2007 Officer Cooper and a colleague visited H&C's principal place of business in Staines, Middlesex. They were not able to meet a director and left a letter stating that the business was deregistered with effect from 23 January, 2007. No contact was received from H&C in response to this letter. Therefore, Officer Cooper wrote to Mr Nawaz at his home address on 27 February, 2007 advising him that the business had been deregistered for the purposes of VAT with effect from 23 January, 2007. H&C did not appeal this decision.

281. On 13 March, 2007 Officer Cooper wrote to Mr Nawaz advising him that the 09/06 VAT return remained outstanding and that information obtained led her to believe that sales were undertaken during this period. She requested that the VAT return and any payment due be submitted within seven days. The letter, addressed to the principal place of business, was later returned by Royal Mail to HMRC as returned mail.

282. On 19 March, 2007, Officer Cooper wrote to the company secretary of H&C, a company called Companies4u.com. Mr Malcolm Roach of Companies4u.com replied to that letter on 19 March, 2007. Mr Roach confirmed that Mr Nawaz had purchased the company on 11 July, 2006 and that Mr Nawaz was appointed a director on 9 May, 2006. Companies4u.com had been appointed to act as company secretary and to provide a book-keeping service. Mr Roach reported that he had on numerous occasions requested accounting information from Mr Nawaz. On each occasion, however, that Mr Nawaz promised to submit records, he had failed to produce them. Mr Roach stated that on 8 December, 2006 he had received a substantial amount of invoices (both sales and purchases) in e-mail form. After reviewing the information Mr Roach believed the deals were fraudulent and therefore discussed the details with Mr Nawaz. Mr Nawaz requested that the information be cancelled and all data destroyed. On 13 December, 2006 Mr Roach wrote to Mr Nawaz informing him that Companies4u.com would no longer be representing the company as they did not wish to be involved in any potentially fraudulent activity. Mr Roach believed that Mr Nawaz was now living in Pakistan.

283. H&C was now insolvent and was currently controlled by the Official Receivers Office. HMRC are seeking to recover a total of £3,321,373 in respect of outstanding VAT calculated as follows:

Period	**Type of debt**	**Amount due**
09/06	Central Assessment	£158.00
09/06	Officers Assessment	£1,478,555.00
12/06	Central Assessment	£1,478,121.00
Final period	Final Period Assessment	£364,539.00
Total Tax Due		**£3,321,373.00**

284. Having received no reply from H&C to her letter of 13 March, 2007, Officer Cooper raised an assessment in respect of undeclared output tax on deals made with HKS.

285. In August 2006 H&C undertook 11 deals where they sold goods to HKS. The deals took place between 9 August, 2006 and 17 August, 2006 as follows:

09 August, 2006 = 2 deals

10 August, 2006 = 1 deal

11 August, 2006 = 2 deals

14 August, 2006 = 2 deals

15 August, 2006 = 1 deal

16 August, 2006 = 1 deal

17 August, 2006 = 2 deals

286. In each of the above deals undertaken by H&C no output tax was declared. This resulted in a VAT loss of £1,478,561.77. On account of its failure to declare its sales H&C was assessed for £1,478,555. The notice of assessment and statement of account was sent to H&C on 15 June, 2007. The letter was later returned by Royal Mail on 25 June, 2007. H&C did not contact HMRC and has not appealed against the assessment or against HMRC's decision to deregister the company. The assessment remains unpaid and returns for VAT periods 09/06, 12/06 and for the final period have not been submitted.

287. In cross-examination, Officer Cooper confirmed that HMRC had not published information in respect of contra-trading and that Officer Cooper first became aware of

contra-trading at some time in 2006. In Officer Cooper's view a participant would only know about a contra-trading scheme if it was a co-conspirator.

288. Mr Young criticised various passages in Officer Cooper's witness statement which were statements of opinion. Officer Cooper accepted that statements of opinion should not be included in a witness statement. Mr Young further suggested to Officer Cooper that such statements were put in as prejudicial material and suggested further that therefore Officer Cooper might leave out pieces of evidence that could be advantageous to the Appellant. Officer Cooper rejected the suggestion.

289. Officer Cooper stated that in 11 of the deal chains, where HKS acted as an acquirer, it purchased from Nordic. The goods were then traded between UK businesses before being exported from the UK by K & M Supplies Ltd to a business named Nordic Sarl which was based in Italy. HMRC obtained information from the Italian authorities which stated that Nordic Sarl did not exist at the declared address. A registered letter was sent to the manager but returned due to a change of address without any communication of any new address. The director, Mario Fiorellinetto, was untraceable at the declared residence.

Our conclusions on the evidence of Officer Cooper

290. In our view, Officer Cooper was a reliable and credible witness. We did not accept Mr Young's suggestion that she might be tempted to leave out relevant pieces of evidence.

291. Although on a few issues (e.g. in relation to the statement to the effect that HKS purchased goods from Nordic in 11 of the acquisition deals or to the effect that mail sent to H&C was returned by Royal Mail) Officer Cooper's witness statements were unsupported by exhibits -- a fact which Mr Young challenged in cross-examination, we do not consider that this made her evidence inaccurate or unreliable.

292. We accept Officer Cooper's evidence as recorded above and find it as fact.

293. Our conclusion, on the balance of probabilities, is that in the three-month VAT period ended 08/06, HKS was a contra-trader involved in the fraudulent evasion of VAT and therefore participated in a scheme to defraud HMRC. The tax loss chains for that period trace back to the defaulting trader H&C (see below). There is no doubt in our minds that the careful balancing by HKS of acquisition deals in June 2006 against broker transactions in August 2006 – which is even clearer than in the period ending 05/06 - represented a contrived pattern of dealing intended to conceal the fact that HKS would otherwise have claimed a VAT input credit refund in respect of its broker deals. Furthermore, the absence of import and export documentation seemed to us highly suspicious when viewed in the light of HKS's failure to provide relevant documentation or any plausible explanation. We do not accept Mr Young's suggestion that this can simply be explained by "triangulation" in every single case. This seemed unlikely and there was no evidence to support this suggestion that we were shown nor was there any record of Mr Saif proffering this explanation. In addition, we accept Officer Cooper's analysis that the mark-ups achieved did not vary by reference to the type of goods being dealt in but rather by reference to whether the deal was an

acquisition, a buffer or a broker deal. We also note the absence of insurance, the fact that HKS paid its supplier only when paid by its customer and the absence of written evidence of inspection of goods. This suggests an artificial and non-commercial series of transactions. As we noted in relation to the evidence of Officer Berry, we also take account of the background of Mr Saif, who had a conviction for a serious offence involving dishonesty and violence. Mr Saif made it clear to Officer Cooper that he did not care about MTIC fraud and from the weight of evidence we consider the explanation for this nonchalant approach was that it was more likely than not that he was an active participant in that fraud.

294. As regards H&C, we consider that, on the balance of probabilities, this company fraudulently evaded VAT. The absence of records means that it was not possible to trace H&C's suppliers and it is possible that H&C was a defaulting buffer. We accept the evidence of Officer Cooper that the trader engaged in transactions in respect of which it deliberately failed to account for tax on its VAT returns. In reaching this conclusion we are satisfied that the information obtained by Officer Cooper demonstrated that there were 11 transactions where H&C failed to account for VAT, that it failed to provide information requested by HMRC and that Mr Roach (its adviser) considered that H&C's deals were fraudulent. We also take into account the fact that it failed to submit VAT returns for its final three periods.

295. Finally, HKS was involved in all the deal chains in which the Appellant participated in June 2006 (see Appendix 3). We have concluded, earlier in this decision, that HKS was a contra-trader involved in the fraudulent evasion of VAT. H&C was a fraudulent defaulting trader in respect of 11 deal chains leading to HKS in 08/06. The Appellant did not dispute the accuracy of these deal chains put forward by HMRC. Accordingly, it follows from our conclusions set out above that all the deals concluded by the Appellant in June 2006 were connected with the fraudulent evasion of VAT by HKS.

Our conclusions on the evidence of Officers Berry and Cooper taken together

296. As we have recorded above, we consider that the evidence of Officer Berry in relation to the period 05/06 and the evidence of Officer Cooper in relation to the period 08/06, when viewed separately, lead us to the conclusion, in respect of each period, that HKS was a contra-trader involved in the fraudulent evasion of VAT. Although it may be unnecessary to do so, we should observe that when the evidence of both Officers is taken together this conclusion is even more compelling. For example, the pattern of trading over the two periods (involving the balancing of acquisition and broker deals) is even more evident and is plainly contrived. This reinforces our conclusion, in respect of each period viewed independently, that HKS was involved in the fraudulent evasion of VAT in both periods. Secondly, in both periods the contra chains go from HKS to Churchill and both companies always make the same fixed profit (in relation to CPUs) before the goods were sold to the Appellant.

Summary of conclusions on connection to fraud

297. For the reasons given above, we consider that the Appellant's transactions in March 2006 (Appendix 1 and Appendix 2) and in June 2006 (Appendix 3) were connected to the fraudulent evasion of VAT.

Whether the Appellant knew or should have known that its transactions were connected with fraudulent evasion of VAT

298. We now turn to consider whether the Appellant knew or should have known that the transactions which it undertook in March and June 2006 (Appendices 1, 2 and 3) were connected with the fraudulent evasion of VAT.

The Appellant's business

The start up

299. We find the following facts in relation to the commencement of the Appellant's business.

300. Mr Shah had been involved in the IT industry since the early/mid-1990s. He had worked for two PC assemblers (Watford Electronics and Lexon Technology). Whilst working for these two assemblers, he communicated directly with the major manufacturers of products such as Intel, Seagate, Samsung and Fujitsu.

301. Later he moved to a company called OEM Computer Distribution, which was specifically involved in high-volume computer component trading, where he sold Intel and AMD CPUs as well as various brands of hard drives, such as Maxtor and Seagate. Whilst working for OEM, Mr Shah had his first contact with some of the well-known and established distributors, such as Ingram Micro, Techdata, Bell Micro, Avnet and Arrow.

302. In early 2000 he set up his own IT trading company, JIT Computer Distribution ("JIT"), which is still trading today.

303. As noted above, Mr Shah was a director and 50% shareholder of the Appellant. Mr Shah had known the other 50% shareholder and director, Mr Khan, for about 16 months before setting up the Appellant. He was a contact of Mr Shah's within the IT business. The other director of the Appellant was Mr Irshad Mohammed. Mr Shah had known Mr Mohammed personally for over 10 years before setting up the Appellant. Mr Khan and Mr Shah had provided the Appellant's start-up capital of £100,000 (£50,000 each). Mr Shah exhibited to his witness statement a document prepared by Mr Mohammed showing movements in the directors' loan accounts. At 30 June, 2007, the Appellant owed Mr Shah £326,397.84 and owed Mr Khan £328,731.42. Those amounts were still outstanding.

304. Mr Khan was the managing director of a company called Matrix Europe Limited ("Matrix Europe"). Matrix Europe employed between 20 and 30 people and was involved in the IT business.

305. Mr Mohammed had a diploma in IT and had also taught IT. He had studied the IT industry, carried out research into it and had worked in IT support for the Bank of Scotland. Prior to his involvement with the Appellant, Mr Mohammed had little or no experience of running a business and no experience of trading in IT products. He had, in his youth, helped out on a market stall. Mr Shah noted that Mr Mohammed had commercial or business experience (because he worked in IT support for the Bank of Scotland) but when pressed accepted that Mr Mohammed was not very well versed or qualified within the IT industry and was an academic. He was, however, someone whom he felt he could trust.

306. Mr Mohammed was put in the position of running the Appellant on a day-to-day basis. Mr Shah's evidence was that he shared his knowledge of the IT industry with Mr Mohammed over a six-month period prior to Mr Mohammed starting to run the Appellant's business. He trained him over this period by letting him observe the business of JIT.

The business plan

307. We find the following facts in relation to the business plan.

308. In December 2004, Mr Mohammed produced a business plan for the Appellant. The business plan was produced to be shown to banks but it was also shown to Officer Christopher (the Appellant's VAT Officer) at a meeting on 14 February, 2005. When Mr Mohammed, on behalf of the Appellant, completed its application to register for VAT on Form VAT 1 on 5 November, 2004 (see below), the Appellant evidently did not have a bank account because Box 12 on the Form, requesting bank account details, was left blank. By January 2005 the Appellant had opened an account with Lloyds Bank (Aylesbury branch) and we infer that the business plan was used to enable this account to be opened. The business plan was exhibited to the witness statement of Mr Mohammed.

309. The business plan was subject to extensive scrutiny, particularly in cross-examination of Mr Shah and Mr Mohammed, in the course of these proceedings. It is therefore worth setting out the full text of the business plan:

> "*Market Overview*
>
> This business plan gives the vision and strategic focus of DIGI Trade Ltd (DTL). Our business aims to exploit a neglected niche within the Audio Visual/Multimedia market. The current trading hierarchy that exists involves a very constricted chain of entities that have very little leeway in the way that they interact with one another and often times do not even know how to communicate with one another effectively. DTL will thrive in an environment that makes extensive use of:
>
> - Its broad and influential links;
> - Its comprehensive knowledge of business language;
> - Its intimate relations with distributors such as Ingram Micro [footnote: www.imgrammicro.com] and Tech Data [footnote wwwtechdata.com];

- Its appreciation for these sensitivities of the distributor in terms of meeting end of month quotas and bonuses in relation to that;
- The paucity of industry-wide price integrity;
- Its non-commitment to any one distributor;
- Its experience in the manufacturing sphere.

Opportunity and Strategy

The points mentioned above, in and of themselves, are sufficient to guarantee business viability, however DTL's unique selling proposition is the fact that we are in a superior position to buy 'old' stock very aggressively. This in no way means that the commodities are second hand or used, they have simply been superseded by a slightly more developed product. A product that in essence is no different from the original and has the exact same packaging and standard 12 month warranty. DTL will initially focus on the 42" Plasma Screen Market. Plasma screens, like all technological commodities, age very quickly. Technological specifications are constantly improving and newer models hit the markets before previous models have been passed on to the consumer. The newer model is, for all intents and purposes, exactly the same as the 'old' model with minor improvements. For the end user it looks, feels, smells and performs in exactly the same manner, it also has all the important *Samsung, Toshiba, Sony, NEC, LG* etc label. The end user in the vast majority of cases is unaware and in fact does not care that the goods they are purchasing are not at the cutting edge of technology. The end user is initially concerned with cosmetics i.e. is a commodity a brand name? The second main concern need [sic] is practicality/functionality. All they care about is that their bubble wrapped trade brand goods, which they have purchased at a substantially cheaper price, function correctly. Resellers tend to get hung up on the fact that he may have 'old' goods; they are very technologically conscious and have very little appreciation for the end users needs. They take the fact that the new 42" *Phillips Plasmon PL 1040* has twip pixels that have 62 million hues of colour instead of 57 million hues very seriously. They will only accept the newest model and this is where DTL will exploit the market assertively. DTL plans to cut out the Reseller at this stage and buy these 'unwanted' goods directly from the Distributor and pass them on to the end user at a very competitive price.

Market Structure

The basic market structure is as follows:

Manufacturers (Trade brand names: *Toshiba, Sony, Philips etc*)

Distributors (*Ingram Micro and Tech Data*)

Resellers (Small to Medium business enterprises)

End Users (Local/National business as well as governmental departments e.g. Education Sector)

Company Summary

DTL is a Multimedia/AV trading business based in the market town of Aylesbury. We consciously distance ourselves from the satiated IT spheres of trading. DTL was founded in 2003 and has plans for rapid expansion in the coming year.

Company Ownership

DTL is a privately held company. Its founders consisting of two investors and two past employees own it. The investors are Khalid Khan who owns 50% and Iffat Shah owns the other 50%. Irshad Mohammed is the director who is charged with running the business. All are active participants in management decisions.

Future Products and Services

DTL must remain on top of the intimate relationships that it has cultivated with distributors over the past 5 years. Our concern is not specifically new technologies; we aim to deal with goods that are in manufacturer/distributor/reseller terms and 'brand-new' in end user terms. We aim to expand our trade by including OHP's and Projectors with possibilities of looking towards faxes, copiers and printers. Another exciting field that we can look at is the Interactive White Board market.

Market Analysis Summary

DTL focuses on local markets and small businesses, with a special focus on the Education sector. The Director of DTL, Irshad Mohammed, is an experienced educationalist and academic. He holds a Masters in Computing as well as a Postgraduate Certificate in Education (PGCE Secondary AICT). He has taught/lectured at secondary school and university level and is fully aware of the Education sector and its spending patterns. He is in an excellent position to communicate with head teachers and heads of departments.

The Education and Skills Secretary Charles Clarke has stated recently that:

"I am changing the rules and allowing schools to invest their devolved capital money in technology. We need local solutions to local needs to make sure that every pupil gets the most out of the technology available, and schools are best placed to decide where the money should be spent."

> It should be noted that the average expenditure on ICT has risen in primary schools from £68m in 1998 to £201m in 2003 and, in secondary schools, from £143m in 1998 to £223m in 2003. These figures are likely to keep on rising as the British Government has been very pleased at the excellent response in A-C grades in all subjects that have incorporated ICT into their teaching. This equipment is all the more sought-after because it is not only limited to ICT and is used in all subjects from Geography to Law.
>
> *Projections*
>
> There follows a conservative cash flow projection" [attached three sheets of cash flow projections]

310. The cash flow projections attached to the business plan indicated that the Appellant would be in a repayment position in respect of every period for which a return was submitted even though the business plan envisaged sales to domestic UK customers and Form VAT 1 anticipated that the Appellant would not be in a repayment position. VAT registration process

311. A great deal of attention was also paid during the hearing to the Appellant's application for VAT registration. We find the following facts.

312. Mr Mohammed applied on behalf of the Appellant to be registered for VAT. He completed Form VAT 1 on 5 November, 2004. He stated that the principal place of business of the Appellant was Flat 7, Wigmore Court, Aylesbury. He further stated that his home address was Flat 8, Wigmore Court.

313. Question 5 on Form VAT 1 asked as follows:

> "Please tell us about all your current and/or intended business activities."

314. Mr Mohammed answered:

> "MULTI MEDIA TRADING"

315. Question 6 on Form VAT 1 asked the following question:

> "Are you or any of the partners or directors in the business you are seeking to register through this application, involved in running any other businesses either as a sole proprietor, partner or director?"

316. Mr Mohammed ticked the box "No".

317. Question 7 asked:

> "Have you, or any other partners or directors in the business you are seeking to register through this application, been involved in running any other businesses either as a sole proprietor, partner or director in the past two years?"

318. Mr Mohammed ticked the box "No".

319. Mr Mohammed was able to give the answer "No" to questions 6 and 7 because Mr Khan and Mr Shah had resigned four days earlier on 1 November, 2004.

320. Question 10 on form VAT 1 asked:

> "Do you expect to receive regular repayments of VAT?"

321. Mr Mohammed ticked the box "No".

322. Question 23 asked:

> "Please estimate the value of taxable supplies you expect to make in the next 12 months."

323. Mr Mohammed answered: "£9,000,000."

324. Question 25 asked:

> "Please tell us the value of goods you are likely to buy from other EC Member States or sell to other EC Member States in the next 12 months."

325. Mr Mohammed answered, in relation to "Buy", "£ NIL". His reply in relation to "Sell" is not clear, but is either "£ NIL" or "£ N/A". In either case the reply seemed to indicate that exports to EU traders were not envisaged.

326. HMRC (Officer Sam McCann) requested further information in a standard form letter on 2 December 2004. In particular, HMRC asked the Appellant to state the exact nature of the business for which registration was being applied. Mr Mohammed's reply was dated 12 December, 2004 (it is not clear on what date the reply was received by HMRC as the receipt of stamp is unclear, save that it was received in December 2004) and read as follows:

> "Trading in multimedia/audiovisual market. Including plasma screens, CPU's, OHP's and related computer peripherals and components
>
> Please see cover letter re account number."

327. The covering letter referred to by Mr Mohammed was dated 8 December, 2004 (although, as noted, the standard form letter appears to have been signed by Mr Mohammed on 12 December, 2004) and stated:

> "I am in the process of securing a corporate account for DIGI Trade Ltd. It is for this reason that I have not included it in the request for information form that you sent me. Please do not hesitate to contact me if you require any further information."

328. On 13 January, 2005 Mr Mohammed wrote to HMRC:

> "In addition, I had a conversation with Mr Michael Clark on the 11 January, 2005. He told me that I would need to inform the Variations department in writing to make my VAT assessment on a monthly basis instead of quarterly as it currently is. I write this letter so that you can make the necessary changes."

329. HMRC sent an e-mail to the Appellant on 14 January, 2005 referring to the request that the Appellant should be able to submit returns on a monthly basis. The e-mail read as follows:

> "Monthly returns can any be allowed to traders who are entitled to regular repayments of VAT or who can forecast a repayment position covering several months based, for example, on capital expenditure.
>
> Before we consider your request would you please supply the following information:
>
> i) Full details of your business activity i.e. which supplies are standard rated and which are zero rated?
>
> ii) Why do you expect to be in a repayment position?"

330. On 17 January, 2005, Mr Mohammed faxed a reply (from his local library) as follows:

> "I received your e-mail on the 14/01/05 and hope this letter answers the questions highlighted in it. DIGI Trade Ltd will focus on the Multimedia and Audio Visual market, specifically Plasma Screens, Projectors and associated technologies like CPUs and Hard Drives etc.
>
> Our business will operate in both domestic and international spheres. Our main focus abroad will be Africa and North America. We anticipate that 30% of our business will be domestic and 70% international.
>
> We feel that we will be in a repayment position because we aim fully to utilise our extensive supply links in the UK and position ourselves strategically on the international market. We are anxious to take part in this exciting area and have laid the groundwork meticulously for several months now. This is why 70% of our trade will be international. I trust this satisfies you. Please do not hesitate to contact me if you require further information."

331. HMRC then put the Appellant onto monthly returns. Every VAT return thereafter contained a repayment claim.

Evidence in relation to the business plan and VAT registration

332. Mr Waddington cross-examined Mr Shah about the Appellant's business plan. Mr Shah confirmed that Mr Mohammed had produced the business plan, partly based on the six months training that Mr Shah had given him. Mr Shah confirmed that he had approved the business plan. Mr Shah did not know to whom the document had been distributed, although at one point he indicated that the plan may have been shown to HMRC. Mr Waddington asked Mr Shah about the purpose of producing the business plan. Mr Shah replied that it would be necessary to ask Mr Mohammed. He supposed it was to explain to anyone who wanted to know what the Appellant's business plans and proposed activities were. Mr Shah said that he was not involved with filling out forms or writing business plans.

333. The business plan stated:

> "This business plan gives the vision and strategic focus of DIGI Trade Ltd (DTL). Our business aims to exploit a neglected niche within the Audio-visual/multimedia market.... DTL will initially focus on the 42 inch plasma screen market."

334. Mr Waddington asked whether the Appellant had focused on the plasma screen market. Mr Shah replied that it had done so. Its supplier Outernational produced plasma TV screens and offered the Appellant distribution rights. In relation to the first statement, relating to audio-visual multimedia, the Appellant's suppliers offered to the Appellant Harmon Kardon and Hannspree TVs. It was Mr Mohammed's responsibility to see whether he could sell its products. As far as the business plan was concerned, the Appellant had wanted to focus on certain markets. There was nothing wrong with changing the focus and adapting to the demands of clients. However, Mr Mohammed did not, in fact, sell any plasma screens because he considered that it was not commercially feasible.

335. The business plan continued by saying: "DTL will thrive in an environment that makes extensive use of its broad and influential links." Mr Shah explained that these links were those of himself and Mr Khan which they passed on to Mr Mohammed. In particular, they had influence with suppliers that they knew, such as Outernational, Ingram Micro, Enta Technology and VIP Computers. When asked whether the Appellant had dealt with these companies, Mr Shah replied affirmatively. When pressed on this he accepted that the Appellant had contacted Ingram Micro and had "interaction" with those companies, but had not done a deal with them.

336. Mr Waddington asked whether there was anything in the business plan about CPUs or PCs. Mr Shah replied that there was a reference to distributors in the IT industry and electronics industry. He also said that there was a reference to Ingram Micro, the largest Intel distributor of CPUs -- an indirect reference. He accepted that Ingram Micro sold plasma screens.

337. Mr Waddington put it to Mr Shah that the document was all about plasma screens. Mr Shah denied this stating that the plan referred to audio/visual and multimedia -- the multimedia market involved computer software, peripherals and computer components. Mr Waddington asked whether there were any direct references in the document to CPUs. Mr Shah replied that there were "direct industry references, yes". Mr Shah, when pressed, accepted that there was no direct reference to CPUs in the document.

338. He also accepted that the plan indicated that the Appellant was planning to sell to local national businesses as well as government departments e.g. the education sector. It was put to Mr Shah that this bore no relationship to what the Appellant actually did. Mr Shah did not accept this and referred to the references in the document to Toshiba, NEC and Ingram Micro. He expected Mr Mohammed to sell to Ingram Micro.

339. Mr Shah was questioned about the section headed "Market Structure". This comprised a diagram showing manufacturers selling to distributors, which sold to Resellers, which then sold to end users (referred to as "local/national business as well

as governmental departments e.g. Education Sector"). Mr Waddington referred to the earlier statement in the business plan to the effect that the Appellant planned "to cut out the reseller at this stage ..." Mr Waddington suggested that this indicated that short chains meant better profits. Mr Shah did not agree that this is necessarily so.

340. Mr Waddington referred to the business plan under the heading "Company Summary". This section contained a sentence as follows: "We consciously distance ourselves from the satiated IT spheres of trading." Mr Waddington asked Mr Shah if the suggestion was to get away from IT because it was saturated -- i.e. too many companies in that market. Mr Shah replied that that question would have to be put to Mr Mohammed, who had put the business plan together based on his experience and research. Those words represented his opinion. Although according to his earlier evidence Mr Shah had approved the business plan, he did not agree that the IT sector was saturated in December 2004, because he was trading in the sector at that time.

341. Mr Waddington asked Mr Shah what was the purpose of spending six months training Mr Mohammed in the IT industry if he then produced a business plan about plasma screens. Mr Shah replied that the IT industry was not confined to computer components. The IT industry was all electronic goods, software, TVs, plasma screens, games consoles, computer components etc. Mr Waddington put it to Mr Shah that there was never any intention to sell plasma screens. Mr Shah denied this and said that there had been a real intention to do this. Mr Shah pointed out that the business plan mentioned the Audio Visual/Multimedia market and a neglected niche which the Appellant intended to exploit. "Multimedia" did not just relate to one product -- it covered a vast number of products. Mr Waddington pointed out that Mr Mohammed thought that the IT industry was "satiated" and the Appellant intended to “distance” itself from it, so clearly he was not talking about the IT industry in the rest of the document. Mr Shah replied that even if Mr Mohammed mentioned it was saturated (in fact, the business plan used the word “satiated”), he had shown him that that it was not saturated by telling him: “Well, look at the other markets and other products."

342. Mr Mohammed stated that the first draft of the business plan was written in November 2004 and the final document in 2005. It was primarily designed in order to be given to banks so that they could see what the Appellant's business was. He said that he had every intention to trade in plasma screens. He denied that there was any attempt to mislead or be dishonest. He confirmed that he had given it to Officer Christopher. He also thought he had given it to his accountants. The business plan was a general document and reflected his state of knowledge in November/December 2004.

343. It was put to Mr Mohammed in cross-examination that the business plan, which was used by the Appellant to obtain a bank account, gave the impression that the Appellant's business was dealing in plasma screens. Mr Mohammed said that the business plan used the generic term "multimedia trading" which, he thought, was wide enough to include CPUs, software and other components.

344. Mr Mohammed was asked whether the purpose of the business plan was to mislead the bank as to the nature of the Appellant's business -- to avoid awkward

questions being asked. As far as Lloyds Bank was concerned they thought the Appellant's business would be trading in plasma screens. Mr Mohammed denied this and said he had been honest and straightforward with Lloyds. He confirmed, however, that he neither bought nor sold a single plasma screen, although he maintained that he did deal in multimedia products.

345. Mr Mohammed was referred to the sentence in the business plan which said: "We consciously distance ourselves from the satiated IT spheres of trading." He was asked if he meant that there were already too many companies in IT spheres of trading. Mr Mohammed confirmed that that was his understanding in December 2004.

346. As regards those portions of the business plan that indicated that the Appellant intended to cut out the reseller from the supply chain, Mr Waddington asked whether this indicated that short chains were a good idea. Mr Mohammed replied that he had no knowledge of the chains -- he only had knowledge of his supplier and his customer.

347. As regards the VAT registration process, Mr Shah was cross-examined on Form VAT 1 which was completed by Mr Mohammed on behalf of the Appellant on 5 November, 2004 (i.e. shortly before the business plan). In Box 5 the trader was asked to tell HMRC "about all your current and/or intended business activities." Mr Mohammed had filled in the box as follows: "Multimedia trading". Mr Shah said this would cover any multimedia products e.g. Intel CPUs, hard drives, computer components and any other electronic device. Based on his industry experience that was his understanding of the expression "multimedia trading". He considered that it was a clear description. He was asked whether it was of interest to HMRC that the company which is seeking to register for VAT wanted to trade in CPUs or in mobile phones. Mr Shah replied that when he had set up JIT Computer Distribution he had not been told by HMRC that they wanted to know exactly what products it would be trading in.

348. Mr Waddington referred to Boxes 6 and 7 on Form VAT 1 which read as follows:

> "6. Are you or any of the partners or directors in the business you are seeking to register through this application, involved in running any other businesses either as sole proprietor, partner or director?
>
> 7. Have you, or any of the partners or directors in the business you are seeking to register through this application, been involved in running any other businesses either as a sole proprietor, partner or director in the past two years?"

349. In respect of both Boxes, Mr Mohammed had ticked "No". Mr Waddington asked Mr Shah whether, if the form had been filled in three days earlier, the correct answer would have been" Yes", because Mr Shah would still have been a director (see paragraph 40 above). Mr Shah confirmed that this was correct. However, he denied that he was seeking to conceal his directorship from HMRC when seeking registration. In relation to Box 7, Mr Shah considered that there was a mistake on the Form and said that he had notified his HMRC officer verbally that he was a director

of another company which was trading within the industry. Mr Shah said that the officer did not object.

350. Mr Shah was asked in examination in chief why he and Mr Khan had resigned as directors before the application by the Appellant to register for VAT and were then reappointed at a later stage. Mr Shah said that initially he and Mr Khan became directors to show commitment to the new business. However, at the time it was premature (Mr Shah was still running JIT Computer Distribution and Mr Khan was still the managing director of Matrix Europe) so they decided to take themselves off the board as directors and to allow Mr Mohammed to be the sole managing director of the Appellant. Mr Khan had a secure position at Matrix Europe and he had some things on his mind about whether fully to commit to the Appellant's new business. Mr Shah did not want to push him into committing. At a later stage, Mr Shah and Mr Khan were reappointed as directors in order to show some commitment to the new business and because they were advised by their accountants to do so at the time. Mr Shah noted that his family ran an accountancy firm in the City. He knew that it was not difficult to buy a company with a VAT registration as well as a bank account. The reason why Mr Mohammed was allowed to complete the VAT forms was to allow him to become familiar with how a company was formed. Mr Shah did not think there was anything peculiar about being a director one day and resigning another -- it was, said Mr Shah, not unusual.

351. Mr Waddington suggested to Mr Shah that it would, in fact, have caused him no problems if he had remained a director of the Appellant. Mr Shah replied that he had followed the advice of his accountants and that he did not know what the implications or advantages were of being or not being a director. He said that he had made it clear to HMRC that he had another company and that he had nothing to hide. Mr Waddington suggested that it was a feature of Mr Shah's behaviour as he kept information to himself unless he had to give it out. Mr Shah denied this. Mr Waddington put it to Mr Shah that there was no purpose in resigning as a director just before the completion of Form VAT 1 other than to keep in the background and let someone untainted fill out the form and notionally run the company. Mr Shah denied this and said he had made it very clear that he had set up a company with Mr Khan who was an employee of Matrix Europe. At the same time Mr Shah ran JIT Computer Distribution and that they decided to become directors. However, at that time (ie just before Form VAT 1 had been completed) Mr Khan was not willing to leave Matrix Europe and, based on that, Mr Shah had kept JIT Computer Distribution. Therefore, they removed themselves as directors. They were reappointed as directors on the advice of their accountants. In addition, Mr Shah said he had spoken to his HMRC officer and mentioned to him that he was a director in another company.

352. Mr Waddington referred Mr Shah to the letter written by the Appellant (Mr Mohammed) to HMRC on 17 January, 2005 referred to above. Mr Shah confirmed that shortly after this letter the Appellant was put on monthly returns and every VAT return resulted in a repayment claim. Mr Waddington referred Mr Shah to the statement in the letter indicating that the Appellant considered that it would be in "a repayment position" and it is intended to position itself "strategically on the international market." Mr Waddington cross referred to Box 10 on Form VAT 1

which asked: "Do you expect to receive regular repayments of VAT?" The answer was: "No". Mr Shah explained that the Form VAT 1 was completed in November 2004 whereas the letter was dated 17 January, 2005. In November 2004 those involved with the Appellant were discussing whether they wanted to sell domestically and internationally, but the percentages were uncertain.

353. Mr Waddington referred to the statement in a letter of 17 January, 2005 that the main focus of the Appellant's business "will be Africa and North America. We anticipate that 30% of our business will be domestic and 70% international." Mr Waddington asked Mr Shah whether the Appellant sold CPUs in North America. Mr Shah confirmed that, with the exception of one deal, it had not. He also confirmed that the Appellant had not done business in Africa. Mr Shah said that Mr Mohammed had felt that there was a niche in the African market for plasma screens and audio-visuals, but it would be necessary to ask Mr Mohammed about this. Mr Waddington challenged this proposition stating that the business plan was talking about selling plasma screens to schools in England. Mr Shah replied that that could have been discussed in a face-to-face meeting with the bank manager -- sometimes it was possible to elaborate on plans in a face-to-face meeting.

354. Mr Waddington put it to Mr Shah that the Appellant had only disclosed that it was going to trade in CPUs in its letter of 17 January, 2005 when it was pressed to do so by HMRC. That was why Mr Waddington suggested that Mr Shah liked to play his cards close to his chest and give away the minimum of information. Mr Shah disagreed and said he found it insulting to have his integrity questioned.

355. Mr Waddington showed Mr Shah a schedule exhibited to Officer Wood's statement which disclosed the VAT repayments claimed by the Appellant in 2005 and 2006. Mr Shah stated that in these periods the only goods in which the Appellant had traded were CPUs, hard drives and software. The overwhelming majority of goods comprised CPUs. The schedule showed the Appellant to be in a substantial repayment position in every VAT period in 2005 and 2006 until it ceased trading. Mr Waddington put it to Mr Shah that Form VAT 1 and the business plan did not indicate that the Appellant would be regularly seeking repayments. Mr Shah said that it would be necessary to ask Mr Mohammed. However, the letter of 17 January, 2005 did indicate that repayments were expected. Mr Shah accepted that this was after the company was registered for VAT, but emphasised that it was easy to buy a company with an existing VAT registration. He considered that nothing had been hidden.

356. Mr Mohammed was cross-examined about the VAT registration process. He was asked whether the Form VAT 1 referred to CPUs. Mr Mohammed said that the form referred to "multimedia trading". This was a generic term which covered any form or medium i.e. the handling, processing or analysing information. He understood that that term would cover CPUs. He noted that in the letter of 17 January, 2005 to HMRC CPUs were mentioned explicitly. CPUs were also mentioned in the Appellant's letter to Officer Sam McCann of 12 December, 2004.

357. Mr Mohammed accepted that in Form VAT 1 he had indicated that regular VAT repayments were not expected.

358. He was asked for the basis of the claim in the Appellant's letter of 17 January, 2005 to HMRC (which was requesting that HMRC put the Appellant on a monthly return basis) that the Appellant's "main focus abroad will be Africa and North America." He said that the basis for the claim was his research and information that he had at the time. He had several friends who operated in Africa. He had come to this conclusion after discussions with them. He was asked which companies in Africa he was planning to deal with in January 2005. Mr Mohammed could not recall because no deals in Africa actually went through. He confirmed that the Appellant had carried out only one trade with a North American customer.

The conduct of the Appellant's business - HMRC's evidence

359. Officer Wood gave evidence in relation to the Appellant. He had been the responsible officer for the Appellant since 16 March, 2007 and had been an officer of HMRC (and its predecessor HM Customs and Excise) since August 2000. We find the following facts based on his evidence.

360. Officer Wood compiled (and gave evidence in relation to) the deal chain summaries in the Appendices to this decision, which related to the chains in which the Appellant participated and which were not in dispute. Although Officer Wood's reliability as a witness was questioned by Mr Young, we did not understand this to extend to the deal summaries he produced.

361. The Appellant engaged in trading in CPUs from January 2005 onwards. The Appellant was in a repayment position in respect of every VAT return for periods in which the Appellant traded. The Appellant's turnover reported in its 01/05 return was £288,036 and £704,088 in the 02/05 return. Its turnover in the first year of trading (the year ended 31 October, 2005) was £14,203,380. The turnover for the year to 31 October, 2006 was £12,463,867 (although the Appellant ceased trading from July 2006).

362. The principal place of business of the Appellant was a serviced office in Walton Street, Aylesbury. Officer Wood had not visited the Appellant's offices and had not met or interviewed its directors, although other officers had done so. His evidence was based on HMRC's files (including electronic files).

363. The Appellant's returns for 03/06 and 06/06 were selected for extended verification. This showed that on a number of occasions the same pattern of traders (Corinth or World Tagus followed by HKS, and Churchill) appeared in the same order in both in the Appellant's chains and those chains of the contra-trader HKS (i.e. deal chains where the Appellant was not involved, so-called "parallel chains"), and that in the parallel chains another broker was substituted. One of the "substitute" brokers was Matrix Europe the company of which Khalid Khan, one of the co-directors of the Appellant, was also a director. The same companies (World Tagus, HKS, Churchill and the Appellant) featured, in exactly the same order, in 12 of the Appellant's deals in May 2006 (a period not under appeal). The same traders (excluding the Appellant), in the same order, also appeared in two of HKS's deal chains in May 2006

364. The extended verification process also showed that the remaining deal in the 03/06 period (Deal 10) led to a missing trader, DSN.

365. Officer Wood gave evidence regarding his decision to deny the Appellant the right to deduct input tax in relation to the 03/06 and the 06/06 returns. He produced a Table demonstrating the frequency with which these same companies appeared in transactions relating to the 03/06 and 06/06 returns.

Deal No.	Return	EC Supplier	Buffer 4	Buffer 3	Buffer 2	Buffer 1	Broker	Dispatch/Export
1-88	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	Bergmann Associates
2-89	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	Trius Distribution
3-90	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	Solid Storage
4-91	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	E-Future Systems FZE
5-92	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	E-Future Systems FZE
6-93	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	E-Future Systems FZE
7-94	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	E-Future Systems FZE
8-95	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	Zi Enterprises
9-96	March 2006	Corinth EURL			HKS	Churchill	Digi Trade	Zi Enterprises
10-97	March 2006		Data Solutions	Star Express	Hendon Import Export	Outernational	Digi Trade	Solid Storage
1	June 2006	World Tagus Trading			HKS	Churchill	Digi Trade	E-Future Systems FZE
2	June 2006	World Tagus Trading			HKS	Churchill	Digi Trade	E-Future Systems FZE
2a	June	World Tagus			HKS	Churchill	Digi Trade	E-Future

	2006	Trading						Systems FZE
3	June 2006	World Tagus Trading			HKS	Churchill	Digi Trade	E-Future Systems FZE
3a	June 2006	World Tagus Trading			HKS	Churchill	Digi Trade	E-Future Systems FZE

366.HKS and Churchill appeared in all the contra chain deals. Deal 10 was, as noted earlier, a rather different chain with a defaulter in the same chain as the Appellant. Except for Deal 10 the EU supplier was the same for all the deals in 03/06 (Corinth) and for all the deals in 06/06 (World Tagus). As regards the Appellant's customers, E-Future Systems FZE ("E-Future") featured in all the deals in 06/06 and in four of the deals in 03/06.

367. As noted above, the same combination of traders (Corinth, HKS and Churchill) appeared in some of HKS's deals for April 2006. In these chains the Appellant was replaced by other UK traders i.e. More Ltd and Matrix Europe. The reported turnover of the Appellant rose from £288,036 in the 01/05 return (its first return) to £704,088 in the 02/05 return even though its initial capital was still only £100,000. The Appellant's turnover for the year 1 November, 2004 to 31 October, 2005 was £14,203,380 and for the year 1 November, 2005 to 31 October, 2006 the turnover was £12,463,867. After July 2006, the Appellant's VAT returns were mainly nil returns, following HMRC's decision to deny input claims.

368. Officer Wood examined the profit margins in the various deal chains in which the Appellant participated. As regards CPUs the mark-up between Corinth and HKS was always £0.25 and between HKS and Churchill was always £0.20 in respect of both the 03/06 and 06/06 periods. As regards software deals (Deals 8 and 9 in 03/06) the profit margin was £0.50 for both companies. As regards Deal 10, Star Express and Hendon Import both made £0.18.

369. No written contracts were provided in relation to any of the transactions entered into by the Appellant in respect of the relevant deal chains. The only documents were documents such as invoices and purchase orders.

370. Generally, the deals were back to back and mainly took place on the same day.

371. All the companies in the UK part of the chain purchased exactly the same goods in exactly the same quantities and sold on exactly the same quantities. None of the participants in the UK part of the chains were left with unsold goods. The consignment of goods moved from one participant in the chain to another until the goods were exported from the UK.

372. None of the companies in the chain from the UK importer to the broker made a loss.

Conduct of the Appellant's business – evidence of Mr Shah and Mr Mohammed

373. As noted above, Mr Shah and Mr Khan left the day-to-day running of the Appellant to Mr Mohammed. However, they were in contact with him regarding the transactions which the Appellant was entering into and the suppliers, customers and freight forwarders which the Appellant was using.

374. Mr Shah confirmed that he was in contact with Mr Mohammed as regards the day-to-day running of the company. He would call him on a weekly basis (or sometimes on a daily basis) just to see how things were. He left Mr Mohammed to his own devices to run the company and to trade with the knowledge that Mr Shah and Mr Khan had given to him. However Mr Shah did confirm that he wanted to know what deals Mr Mohammed had done ("With any employee you want to know how they are getting on with their work.")

375. Asked in cross examination how Mr Mohammed found his customers, Mr Shah replied that Mr Mohammed went to CeBIT, the largest IT computer fair in the world. It was an excellent place to meet clients and to get to know international clients. Mr Shah believed that Mr Mohammed had attended CeBIT once before he started trading and had attended once or twice in total. Mr Mohammed would also contact reputable clients through searches on the Internet and telephone potential clients on a daily basis. It was Mr Mohammed who had found the Dubai-based E-Future Systems as a purchaser.

376. Mr Shah was cross-examined on how the Appellant had achieved a £14 million turnover in its first year of trading from a standing start, when it was run by someone with little commercial experience. Mr Shah said that both he and Mr Khan acted as consultants for Mr Mohammed and gave him the advantage of putting him in touch with suppliers -- although Mr Mohammed found his own customers. Mr Shah accepted that in the two periods under appeal there was only one supplier (Churchill), except as regards Deal 10 (Outernational). Mr Shah confirmed that he did not know Churchill -- he thought this was a contact of Mr Khan. Mr Shah confirmed that Mr Khan and Churchill were not being called as witnesses for the Appellant.

377. In cross-examination, Mr Shah said that he only knew that the Appellant's suppliers and customers were reputable companies -- he did not know about his supplier's supplier. The activities of the Appellant's supplier's supplier did not concern him: they had nothing to do with him or with the Appellant. He accepted, having read the papers, that a fraud was being operated but denied that the Appellant was involved in it.

378. In relation to JIT Computer Distribution, Mr Shah said that he had always had a very comfortable relationship with HMRC officers. The officer that he dealt with was Mr Dave Atkins -- a senior officer at the Euston branch in London. Mr Atkins had visited Mr Shah twice and otherwise Mr Shah spoke to him on the telephone. Mr Shah sent Mr Atkins Excel spread sheets of his suppliers and his customers. It was never suggested to him that he was doing anything out of the ordinary or buying from suppliers who were involved in anything "dodgy". It had never been suggested to Mr

Shah that JIT Computer Distribution was suspected of being involved in MTIC trading. Mr Shah had never met or received a visit from Officer Wood.

379. Mr Mohammed's evidence in relation to Mr Khan was somewhat contradictory. At one point he said that Mr Khan had not told him about his (i.e. Matrix Europe's) business, the products that he dealt in or "his relationship with anyone." At other points in his evidence, however, he stated that Mr Shah and Mr Khan gave him information about potential customers and suppliers.

380. Mr Mohammed's evidence was that he carried out research on customers on the Internet and reviewed a manual of contacts obtained from the CeBIT conference (which contained contact details for thousands of IT companies). He did his own research and made approximately 100 "cold calls" a day. He would write on two large whiteboards information concerning various calls he had made to different companies and what prices they were looking for and what stock they were willing to supply. He only recorded in his database what he thought to be the most productive conversations or communications. In addition, he would communicate with potential trading partners via MSN messages. He also maintained a desk diary.

381. During the periods covered by this appeal, Mr Mohammed was helped by an administrative assistant, Barbara Smith. Her role was mainly to ensure that the documentation in relation to deals was in order.

382. Mr Mohammed, in cross-examination, stated that he had no knowledge and no means of knowledge of what profit mark-up was being made by the two suppliers in the deal chain before his immediate supplier (i.e. Churchill or, as regards Deal 10, Outernational). Mr Mohammed said that he had no knowledge of the chain. He only knew what was offered to him by his immediate supplier. He bought from his supplier and sold to his customer.

383.In cross-examination, Mr Waddington suggested that the deals concluded by the Appellant were not genuine arm's-length trading and that doing the deals was "all too easy". In response, Mr Mohammed said that during a luncheon adjournment he had visited IT shops on the Tottenham Court Road, close to the Tribunal, and had negotiated three separate deals for Intel CPUs. This was evidence of a considerable amount of work in negotiation that went into concluding these transactions. Mr Mohammed complained that HMRC did not see the work and the negotiation that went into the transactions under appeal. He claimed that he had managed to negotiate a third off the marked price. He had no intention of buying the CPUs or selling them but had merely carried out the exercise to demonstrate the amount of work that went on behind the scenes.

Participants in the deal chains

384.We make the following findings in relation to other participants in the deal chains in which the Appellant participated.

385. *Corinth*: Corinth was a French incorporated company. Its director was Mr James Alexander Niforopulos, who had a UK address in London. Mr Niforopulos was

sentenced at Croydon Crown Court on 3 December, 2007 to a total of three years and four months imprisonment for offences of dishonesty. Corinth was deregistered by the French authorities on 11 January, 2007 as a missing trader.

386. *World Tagus*: World Tagus was a Portuguese incorporated company. The director, Mr Javaid Sarwar, had a UK address in Ilford, London. The Portuguese authorities confirmed that VAT declarations had been made only until the fourth quarter of 2002. The company was inactive and in all probability a conduit company.

387. *Zi Enterprises*: was a Turkish registered company. The director, Mr Ishaq Mohammed Zamir, had a UK address in Slough. He also ran Saphire, another Turkish registered company.

388. *Churchill*: Churchill was in liquidation and was deregistered for VAT by HMRC on 24 April, 2007. Churchill's directors, Mr Zulfiqar Mahmood and Mr Sajad Khan, had an address in Slough.

389. *Trius Distribution Channels*: Trius was a Netherlands registered company which was deregistered for VAT by the Netherlands authorities on 1 January, 2008 because there were no business records to support its activities.

390. *Data Solutions Northern*: DSN (Deal 10) was deregistered on 8 September, 2006 as a missing trader, with no records to support its activities.

391. *Star Express Ltd:* Star Express (Deal 10) was deregistered by HMRC on 12 September, 2006.

The Appellant's awareness of MTIC fraud

392. Officer Wood gave evidence about the Appellant's general awareness of MTIC fraud. We find the following facts.

393. The Appellant was granted VAT registration on 5 January, 2005, backdated to 1 November, 2004. The Appellant was first visited by HMRC (Officer Christopher) on 14 February, 2005. The visit report stated that Mr Mohammed had received the Redhill clearance letter dated 2 February 2005 (a letter which advised traders trading in sectors where MTIC fraud was problematic to verify the VAT status of new customers and suppliers with the HMRC VAT office in Redhill). The purpose of the letter was to tell traders that they should check with the Redhill to ensure that their customers and suppliers had valid VAT numbers. Officer Wood noted that the Appellant had already been checking with the Redhill office prior to receiving the letter of 2 February, 2005. The report also stated that Mr Mohammed was aware of MTIC fraud and that there was a discussion about the background checks required on customers and suppliers.

394. HMRC issued VAT Notice 726 to the Appellant on 14 February, 2005. This Notice explained HMRC's policy on joint and several liability of the members of a supply chain containing a tax loss. The Notice also advised traders on due diligence procedures that a reasonably careful trader would undertake.

395. Officer Wood referred to "Redhill letters" that had been sent to two other companies of which Mr Shah was a director: EXI Cosmetics Ltd (“EXI Cosmetics") and JIT Computer Distribution Ltd ("JIT"). The letters were dated 4 November, 2003 and 20 August, 2003 respectively. Officer Wood confirmed that JIT operated in the same business sector as the Appellant.

396. HMRC wrote to the Appellant on 18 January, 2006 informing it that all of the Appellant's 13 deals in May 2005 traced back to tax losses. The letter drew the Appellant's attention to the provisions relating to joint and several liability.

397. As regards the Appellant's VAT return for 03/06, the return consisted of two elements: business expenses of £939.41 and a refund claim of £476,280.19 in respect of 10 deals (the subject of the two denial letters dated 12 October, 2007 and 11 April, 2008).

398. In relation to the 06/06 return, the business expenses claims were £837.87 and a refund claim of £87,176.26 in respect of three deals (the subject of the denial letter dated 12 October, 2007).

399. HMRC wrote to the Appellant on 4 December, 2007 requesting additional information on the business expense claims and followed this up with a further letter on a January 2008. Because full information was not received, a demand letter followed on 28 January, 2008. After the expiration of the deadline in the demand letter since complete information had still not been received, the two expense claims were assessed by HMRC as described in a letter dated 22 February, 2008 and in two letters on 13 February, 2008.

400. In cross-examination of Officer Wood and Officer Stone, both officers accepted that HMRC had published no guidance to traders in relation to contra-trading and how to discern whether it was taking place.

Insurance

401. We find the following facts in relation to the Appellant’s insurance arrangements.

402. The Appellant took out an insurance policy in respect of its goods. The policy liability limits for the year commencing 25 April 2005 were as follows:

- £400,000 any one vessel or aircraft or conveyance or location
- £400,000 any one accident or occurrence or series of accidents or occurrences arising out of one event in any one location
- £25,000 any one vehicle the property of the Assured and/or within their care and/or custody and/or control arising out of any one accident or occurrence or series of

accidents or occurrences arising out of one event in any one location

- £400,000 any one accident or occurrence or series of accidents or occurrences arising out of one event in respect of subject-matter in store at the following specified location: ABX Logistics, Hounslow and other locations to be specified.

403. Deals 8 and 9 in relation to the 03/06 return, both relating to E-Auz software, exceeded the value covered by the insurance. In relation to Deal 8 the value of the goods exceeded £1 million and in Deal 9 the value of the goods was slightly under £600,000. For the reasons given later, we did not find Mr Mohammed's explanation regarding the Appellant's insurance arrangements convincing.

404. Mr Mohammed accepted that the value of these two deals exceeded the insurance cover. However, he had calculated that out of 113 deals, a coverage limit of £400,000 would cover 93% of deals. His analysis was that a 7% chance of not receiving the full value of the goods in the event of a claim was a reasonable risk to take. The Appellant would still get some money back, even if not the full value. The level of coverage represented a commercial decision taken by Mr Mohammed. For reasons given later, we were not convinced by Mr Mohammed's evidence on this point.

Due Diligence

405. We make the following findings in relation to the Appellants' due diligence.

406. Officer Wood noted that, as already mentioned, the Appellant had received a "Redhill letter" on 2 February 2005 requiring the Appellant to check the VAT registration of its trading partners with HMRC's Redhill office. He noted that the Appellant had received seven veto letters from HMRC warning them not to trade in respect of companies which had been deregistered, although he conceded in cross-examination that these seven letters post-dated the periods under appeal. Also, as already noted, HMRC notified to the Appellant that tax losses had been identified in 13 transactions in the 05/05 return.

407. Officer Wood considered that the due diligence checks made by the Appellant were weak. A Dun & Bradstreet report (updated 22 February, 2006) showed that the Appellant's supplier Churchill was more likely to fail than the industry average (the failure score was 16/100 -- where 1 is the highest and 100 is the lowest risk of failure), yet the Appellant purchased from them repeatedly in March and June 2006.

408. In relation to Deal 1, Officer Wood had seen no due diligence documents in respect of the Appellant's customer Bergmann Associates. In relation to Deal 2, the Appellant requested confirmation from Redhill in respect of its customer Trius Distribution Channels BV ("Trius") and received a response validating the customer's VAT registration on 30 August, 2006, although the Appellant entered into Deal 2 with Trius on 14 March 2006. The letter also confirmed the validity of the Appellant's customer Solid Storage Solutions ("Solid Storage") with which the Appellant had

entered into a transaction on 16 March 2006. However, in re-examination of Mr Mohammed it was noted that a Redhill confirmation for Trius was requested on 9 March 2006 and was obtained on 11 April, 2006. In relation to Solid Storage Solutions the Appellant had received a Redhill confirmation on 28 October, 2005 and on 28 December, 2005.

409. Dun & Bradstreet, in a report dated 31 March, 2006, gave Trius a high risk of failure (22/100 -- where 1 is the highest and 100 is the lowest). The Appellant completed a deal with Trius on 14 March 2006, apparently not waiting until the report was ready. In relation to Solid Storage, a Dun & Bradstreet report dated 28 March, 2006 gave Solid Storage a low risk of financial failure (98/100) but the report post-dated the deal on 16 March (Deal 3) which the Appellant entered into with that customer.

410. Trius indicated in their introductory letter (a fax dated September 2006) that they were an official distributor for Maxtor (computer hardware), but there was no evidence that the Appellant ever approached Maxtor themselves.

411. As regards Deals 4, 5, 6 and 7 in the period 03/06 and Deals 1, 2, 2a, 3, 3a in the period 06/06 where the Appellant sold goods to E-Future Systems FZE ("E-Future"), due diligence consisted of a request for a Dun & Bradstreet report dated 1 September, 2006, a site visit on 25 July, 2006 which indicated that E-Future were Maxtor official distributors. However, the only trade references taken up were from two other Dubai-based companies. All the documents were dated after the deals had taken place in March 2006.As regards Deals 8 and 9 in relation to the period 03/06, in which the Appellant sold goods to Zi Enterprises Tek Urun Ve Dis Tic Ltd (a Turkish company) minimal due diligence material was supplied. The due diligence material consisted of a letter of introduction (and terms of trade), details of the company (including its FCIB account), a trade application form dated 23 March 2006 and a due diligence assessment form (in which Zi Enterprises admits that it authorises third party payments.

412. In his evidence Mr Mohammed indicated that he had contacted Zi Enterprises in relation to their answer in respect of third party payments and it was apparent that because of their poor English they had misunderstood the form and that they did not authorise third party payments. In addition, Mr Mohammed exhibited references obtained from Zi Enterprises's lawyer and accountants. Both letters are dated 28 March 2006 and are in virtually identical form stating that the company was in good standing and had no outstanding creditors. In relation to Deal 10 where the Appellant's supplier was Outernational Ltd, the due diligence material consisted of a Redhill validation letter dated 8 November, 2005 and an undated Dun & Bradstreet report (based on information last updated on 29 November, 2005). The failure score for Outernational Ltd was low (67/100, indicating a lower risk of failure. The report indicated, however, that the director of Outernational Ltd was Bobby Kalia and that he was also a director of Atec Associates Ltd. Atec Associates Ltd were also the Appellant's supplier in all deals in May 2005. As noted above, in a letter dated 18 January, 2006 the Appellant had been warned that all those deals traced back to tax losses.

413. Mr Mohammed also carried out a validation of Storage Solutions VAT Registration through the Europa Website (Operated by the European Commission) and received a validation response dated 16 May, 2006.

414. Mr Mohammed also exhibited to his witness statement due diligence checks carried out in respect of Churchill including Redhill validations dated 6 April, 2006, 5 May, 2006, 6 June, 2006 and 12 June, 2006, a Europa validation dated 5 June, 2006 and a manuscript note of a check with HMRC's National Advice Line dated 6 June, 2006 (quoting a call reference number).

415. Mr Mohammed stated that he had also obtained proof of ID of Churchill's directors and a reference from their accountants (both exhibited to his witness statement). He had also visited Churchill's premises on 20 March, 2006.

416. As regards Outernational (Deal 10 in 03/06), Mr Mohammed exhibited to his witness statement Redhill validations dated 5 October, 2005, 22 December, 2005 and 3 February, 2006, together with a Europa check dated 16 May, 2006 (although this last check was after the date of Deal 10), a certificate of incorporation, a VAT certificate and Companies House documentation.

417. Mr Mohammed also exhibited to his witness statement a Redhill confirmation dated 28 October, 2005 for Solid Storage Solutions BV.

418. In addition to the above findings of fact we heard additional evidence in relation to due diligence which we record below.

419. Mr Shah was asked whether he saw the checks that Mr Mohammed carried out on Churchill by way of due diligence. He replied that he had not seen them. He understood that Mr Mohammed was talking to the Appellant's advisers, who were helping him as regards due diligence checks. Mr Mohammed had told him that he had approved Churchill and that was enough for Mr Shah. He understood that Churchill was a company that was also supplying Matrix Europe. He considered that Matrix Europe was a reputable Hewlett-Packard broker.

420. Mr Mohammed considered that his due diligence had been more than acceptable. He said that he had hired Borders VAT -- a VAT consultant to assist on due diligence.

421. As regards Outernational, Mr Mohammed said that he had visited Outernational's premises and confirmed with Mr Kalia that Outernational bought from different suppliers than those used by Atec and that Outernational's due diligence was tighter than Atec’s had been.

422. Mr Mohammed was cross-examined about the Dun & Bradstreet report in respect of Churchill: in particular, the fact that it had a potential failure score of 16/100 i.e. a high risk of failure. Mr Mohammed stated that he did not extend credit to Churchill.

423. In relation to the credit risk in respect of the Appellant's customers, goods were only released after the Appellant had been paid. Therefore, a Dun & Bradstreet report had very little influence in that case.

424. As regards E-Future, Mr Khan had visited the offices when he happened to be in Dubai. The report indicated that they were Maxtor authorised distributors

Goods traded: E- Auz Software

425. We find the following facts in relation to E-Auz software.

426. Deals 8 and 9 in the 03/06 period involved the Appellant buying and selling E-Auz software. Officer Wood became aware of concerns in respect of the authenticity of E-Auz software from information obtained elsewhere within HMRC. The concerns arose from deals in E-Auz software (albeit different types of software from those concerned in deals to which the Appellant was a party) between Churchill and Matrix Europe (of which, as noted above, one of the Appellant's directors, Khalid Khan was also a director) in March and April 2006. Three software samples were uplifted by HMRC's officers from Churchill on 23 January, 2007. An employee of Churchill, Shamriz Khan, stated that the software, including the uplifted samples, had been on Churchill's premises for some time and he believed that they had been supplied by HKS in early 2006, preceding his arrival at Churchill. The three discs were as follows:

(1) E-Auz Visual Guide for Microsoft Front Page

(2) E-Auz Software Maya

(3) E-Auz Software Visual Guide for Microsoft Power Point

427. These discs were subsequently examined by Mr Peake, whose evidence is set out below.

428. Matrix Europe traded in E-Auz Software Visual Guide for Maya buying from Churchill on 28/04/06 and selling to Future Tech Electronic Components (a Canadian company) on 28/04/06. Matrix Europe also traded in E-Auz Software Customer Relationship Manager, buying from Churchill and selling to Future Tech Electronic Components on 28/04/06. Matrix Europe also bought E-Auz Software Visual Guide for Macromedia Dreamweaver from Churchill and sold it to Future Tech Electronic Components on 31/03/06. Finally, Matrix Europe bought E-Auz Software Visual Guide for Visio from Churchill on 31/03/06 and sold it to Future Tech Electronic Components on the same date.

429. There was some dispute about E-Auz Software taken by HMRC from Matrix Europe. In re-examination, Officer Wood could not recollect details about E-Auz Software taken from Matrix Europe. Officer Wood was recalled and he was shown a letter from HMRC from Borders VAT Services dated 20 April, 2006 which referred to samples of software being taken from Matrix Europe in a visit by Officer Parsons on 31 March (2006). Officer Wood stated that HMRC officers visited the address of Matrix Europe on 31 March, 2006 and examined two pallets of training software from which they took samples. One of the samples referred to in the letter was "Visual Guide for Dreamweaver". Mr Young asked why this letter was not exhibited to

Officer Wood's witness statement. Officer Wood did not know and this was the first time he has seen this letter and said that he was not in a position to give any evidence about the letter.

430. Officer Wood wrote to the Appellant on 6 July 2007 expressing concerns about the authenticity of the software and asking 22 questions about it. The Appellant did not reply to that letter. Mr Mohammed, in his witness statement, indicated that he did not reply to the letter because the correspondence related to goods which the Appellant had not bought and sold. However, as Mr Waddington pointed out in cross examination, the letter referred generally to E-Auz software. Mr Mohammed thought that he had already answered questions from Officer Christopher but could not recall whether he had responded to Officer Wood's letter. When pressed he accepted that it appeared that he did not respond to the letter. He later suggested that he may not have answered the letter because he did not know who Officer Wood was. He denied that he had not answered the letter because he knew the software was bogus.

431. Mr Mohammed stated that he had demonstrated the software to Officer Christopher and Officer Walkerdine.

432. We heard evidence from Mr Peake, a computer forensic analyst and a director of Aperio Digital Investigations Ltd. His experience in computer crime investigation and evidence recovery dated back to 1987. From 1997 to 2002 he served in the Bedfordshire Police Fraud Squad specialising in computer crime investigations. From 2002 to 2005 he served as the computer crime investigator for Bedfordshire Police in their High-Tech Crime Unit.

433. Mr Peake gave evidence about software which he examined in March 2007. He examined the package which purported to contain software produced by E-Auz Software called "Visual Guide for Macromedia Dreamweaver." He was asked to ascertain whether the package contained a genuine software product.

434. Mr Waddington explained to Mr Peake that the item he had examined was retrieved on 31 March, 2006 from Matrix Europe. Mr Waddington also referred Mr Peake to the deal sheet relating to Matrix Europe relating to a deal carried out on 31 March, 2006. In that deal chain Corinth sold "E-Auz Software Visual Guide for Macromedia Dreamweaver" to HKS, which sold it to Churchill which sold it to Matrix Europe and which then exported it to Future Tech Electronic Components. Mr Peake confirmed that he had examined this sample of E-Auz Software Visual Guide for Macromedia Dreamweaver. The deal chain involved approximately 15,000 units.

435. Mr Peake also confirmed that he had examined three other discs. Mr Waddington indicated that the discs had come from Churchill, in accordance with the evidence of Officer Wood, but Mr Peake could not confirm where they came from.

436. Mr Peake confirmed that the disc had the printed title "Visual Guide for Macromedia" on it. On the backface of the slip sleeve it stated: " E-Auz Software. E-Auz Software learning centre has been a leader in providing Microsoft training for over 7 years." On the front of the pack were Microsoft icons in respect of the

operating system that the disc was designed for. The disc was intended to be a guide on how to use Macromedia Dreamweaver -- a well-known web development tool used for designing websites. However, Macromedia was an entirely separate company from Microsoft and was currently owned by Adobe. Mr Peake could see no relevance to the reference to Microsoft -- Macromedia Dreamweaver was not a Microsoft product.

437. Printed on the back of the slip sleeve was a copyright claim by "E- AUZ SOFTWARE". At the back of the printed Quick Start Guide were the words:

> "If you have any questions, suggestions or problems, feel free to e-mail us at the following address
>
> suppport@e-auzsoftware.com
>
> http://www.e-auzsoftware.com"

438. Mr Peake noted the spelling of "suppport" [sic] in the e-mail address. Mr Peake confirmed that the same words appeared on the other three discs.

439. Mr Peake established that the domain name was not registered. Neither the website nor any corresponding e-mail addresses existed. Mr Peake searched for a website with this domain name on the archives of websites known as the Way Back Machine held at www.archive.org to establish whether such a website may have been in existence and then subsequently closed down before his search in March 2007. The website was not in the archive. Mr Peake considered that it was unlikely that a website used by a commercial software provider would not be included on this archive.

440. Mr Peake confirmed that the disc contained eight files and no folders. He viewed the files chronologically and established that six files had a “File Created” date of 10 March, 2006 and two files had a File Created date of 12 March, 2006. This was therefore the last date on which the developer/author or others could have carried out any work on the software, following which it was possible that a master was cut. The master cut would then be used to manufacture a mould from which production CDs were manufactured for sales/distribution.

441. The disc contained a PDF file called "Quick Start Guide for Dreamweaver". It appeared to be the same document as the printed booklet contained within the CD case. The CD auto-ran when placed on Mr Peake's CD drive. It displayed an instruction to start E-Auz Visual Guide for Dreamweaver, click "OK", and to quit without installing, click "Cancel". Mr Peake selected "OK" and the installation then displayed the following message:

> "Could not register type library for file C:\Program Files\ E- AUZ Softwares\ E-Auz -- Visual Guide for Dreamweaver\ Flash 8.ocx . Contact your support personnel."

442. Mr Peake selected the "Try Again" option, and the above message was immediately displayed again. Mr Peake also noticed the misspelling of "Softwares". Mr Peake then pressed the "Continue" button and the installation then proceeded,

placing an entry in Start> Program of E- AUZ Softwares> Visual Guide for Dreamweaver. Again, Mr Peake noted the misspelling "Softwares". The screen display then said "Please enter 15 digit serial key from the back of the CD cover to register your application." There was no serial key on the back of the CD cover, but Mr Peake found a serial number in the Quick Start Guide. He typed this number into the dialogue box and pressed the "Register online" button and an error message was then displayed. The message indicated that the installation process was trying to contact an Internet address but that the address did not exist at the time Mr Peake performed this procedure. Therefore, Mr Peake could not register the product nor complete any installation that may have been underway.

443. Mr Peake carried out Internet research using a number of different search engines but was unable to find any online references to the product. If the product was commercially marketed and distributed, Mr Peake would have expected that, if there had been a problem with the registration program, other people who had bought it would have complained about this in online forums and support groups. However, he found no such complaints.

444. Mr Peake noted that when using Google to make a search, it also includes historic references because Google takes a copy of information ("cached results") so that it was possible to see either the up-to-date result or the cached result. However, there were no references to the product.

445. Macromedia Dreamweaver came with an extensive printed manual with comprehensive instructions on how to install the product and how to use it. Adobe (the owner of Macromedia) provided very comprehensive online training and tutorials via their website. Mr Peake had found nothing similar for this product. An Internet search for Dreamweaver tutorials resulted in over 2 million hits, with an extensive network of support from Dreamweaver users, forums, bulletin boards etc.

446. In cross-examination Mr Peake did not know whether the Appellant had actually traded in this product. His instructions were simply to establish whether the software provided to him by HMRC was a genuine product. It was, however, accepted by HMRC that the Appellant had not traded in this particular type of E-Auz software. Mr Peake did not know whether the software had been traded by Matrix Europe. He had not given evidence in a tribunal hearing relating to Matrix Europe in October 2010.

447. Mr Waddington formally exhibited the discs which had been examined by Mr Peake.

448. Mr Mohammed's evidence was that the misspelling of the word "suppport" may have been an attempt by E-Auz to distinguish its e-mail address and this may not have been a mistake. He stated that in relation to the software in which the Appellant dealt, he would have made a point of visiting E-Auz's Software's website. When pressed in cross-examination about the fact that there was nothing about E-Auz on the internet, Mr Mohammed said that he could not comment. He said he would, as a matter of due diligence, have made sure he understood the product he was dealing in. We did not find Mr Mohammed's evidence on these points convincing.

Goods traded: CPUs

449. We heard evidence from Officer Dean, who also submitted a witness statement. Officer Dean is a member of HMRC's MTIC team based in Oxford and more recently in Reading. He was the designated officer for the suspected MTIC brokers PGT (UK) Ltd and Pelix Ltd.

450. Officer Dean had carried out research into whether boxes of CPU's had been exported not only by those two companies but also by other UK brokers. In the case of PGT and Pelix he had discovered that the goods had been imported and exported from the UK more than once. He had set up a spread sheet containing the relevant information (including the box numbers belonging to CPUs exported by the brokers for which he was responsible). Once entered into the spreadsheet, the data could be electronically sorted, thereby enabling identical box numbers to be readily identified. Other Officers (including Officer Wood) had requested that this pool of data be used to determine whether boxes of CPUs exported by their brokers were also subject to circularity.

451. Officer Wood forwarded details of 12 box numbers belonging to CPUs exported by the Appellant in period 03/06. He requested that Officer Dean check those box numbers against those contained in the spreadsheet to identify any duplicates. Officer Dean supplemented those box numbers with a further 55 belonging to boxes of tray-based CPUs sold by the Appellant in November 2005 and January 2006 recorded on HMRC inspection reports.

452. In November 2005 the Appellant had sold 10 boxes of CPUs to a company called Incoparts in the Netherlands. The deal was cancelled. The Appellant subsequently sold these boxes of CPUs to Solid Storage Solutions in January 2006 -- the original invoice number was retained.

453. On 30 March, 2006, the Appellant supplied E Future Systems FZE (Dubai) with four boxes of CPUs and the sales invoice number 3338 (Deal 7 in period 03/06). This consignment included two boxes of processors with the following box numbers: BH09 LJ04 and BH09T445. On 20 April, 2006, boxes with those box numbers were also sold by PGT to ASAP Trading. On 25 April, 2006, the same boxes of CPUs were sold by Vortech to Tradius (Netherlands). Finally on 22 May, 2006, LTL Communications sold the same boxes of CPUs to Giga Asia (Singapore).

454. The examination of available data, according to Officer Dean, identified that 44 of the 67 box numbers (65%) belonging to tray-based CPUs sold to overseas customers by the Appellant were also exported by one or more other UK brokers.

455. In Officer Dean's view this demonstrated that boxes of tray-based CPUs supplied by the Appellant to its overseas customers were not sold on to their intended end users, but remained in circulation on sale to other UK companies suspected of involvement in MTIC fraud.

456. Officer Dean confirmed that a box of 315 units contained 15 plastic trays each of which held 21 individual CPUs. Intel affixed a label to each box of tray-based

CPUs manufactures, which includes a lot number and an eight digit box number. Officer Dean confirms that his analysis had been based on the box numbers.

457. Mr Young, in cross-examination, suggested to Officer Dean that his evidence simply indicated that goods that were handled by the Appellant may subsequently have been circulated, but not that the Appellant was involved. Officer Dean replied that the fact that the Appellant exported goods which came back into the UK for export by other brokers constituted carousel fraud. However, Officer Dean accepted that there was no evidence that the Appellant sold stock which had previously been sold by UK companies to overseas customers.

458. We accept Mr Young's comments in relation to Officer Dean's evidence. It seems to us that Officer Dean's evidence simply established that the CPUs traded by the Appellant in 03/06 were likely to have been re-circulated by other parties at a later date but not that the Appellant had any involvement.

459. Mr Shah gave evidence about the difference between CPUs in tray form (normally a box consisting of 300+ CPUs stacked in a tray which would be about the size of two lever arch files) and boxed CPUs. CPUs in tray form would mainly end up with assemblers, who were not interested in buying retail boxed CPUs. Retail boxed CPUs usually ended up with retailers such as PC World, Dixons or Currys. The warranties were different because a retail boxed CPU contained extra equipment such as plans and the warranty for retail product would be for a longer period. The inspection of a retail boxed CPU would be different from that of a tray of CPUs. The boxes were in an outer box which would be opened. However, the actual box containing the retail CPU would be shrink-wrapped and would not be opened because once the seal was broken the product was void and no retail outlet would want to buy it.

Evidence relating to the grey market

460. Expert evidence was given by Dr Findlay, an independent consultant advising PricewaterhouseCoopers ("PwC") and other firms on electronics, semiconductors, IT and software markets and technologies. Until January 2009 he was a Director in the UK firm of PwC based in the London office. PwC had been engaged by HMRC to provide evidence on the distribution market for electronic components in 2006.

461. The main companies manufacturing CPUs were Intel and Advanced Micro Devices ("AMD"). In 2006 Intel had a 70.9% and AMD a 26.7% share of the market in manufacturing CPUs. Nearly 70% of Intel's total revenue in 2006 ($35,382m) was attributable to CPUs.

462. Dr Findlay distinguished between different markets in the electronic component distribution market. First, there was the white market, which Dr Findlay described as the legitimate authorised market; secondly, there was the legitimate grey market, which was the legitimate non-authorised market; finally, there was the black market, which was the illegal market comprising stolen and counterfeit goods.

463. As regards the white market, there were two sources of goods. First there was the direct supply between the component manufacturers (Intel and AMD) and large assemblers (e.g. Dell, Hewlett-Packard etc). Secondly, the component manufacturers would supply products to component distributors who would then on sell its products to small assemblers. The assemblers would then sell, generally, to retailers.

464. In 2006 Intel delivered 65.1% of their products directly to their largest customers (e.g. Dell, Gateway and Hewlett-Packard). The largest PC assemblers tended to have a direct relationship with Intel and AMD. In 2006, these CPUs manufactured by Intel and AMD which were not delivered directly to large customers (34.9% for Intel and 56.6% for AMD) were sold through authorised distributors who then resold products into the main regional markets and to smaller PC assemblers in various jurisdictions.

465. Currently Intel had seven five authorised dealers in the UK. The authorised distributors would trade a far greater number of components than just CPUs and would deal with numerous manufacturers.

466. Profits for distributors were very thin. In 2006, the weighted average operating profit margin for the authorised distributors was only 2.3%. The weighted average margins for assemblers and component manufacturers in 2006 were 3.2% and 14.8% respectively. The relatively low profit margins that Intel authorised distributors received for their products made it difficult for smaller distributors to trade profitably in Intel CPUs.

467. Dr Findlay considered the legitimate grey market. There were five main legitimate grey market opportunities.

468. *Sub distribution:* The first market opportunity related to sub distribution. A sub distributor would take components from an authorised distributor and sell them to a computer assembler. Authorised distributors do not provide complete coverage of every possible component from all component manufacturers for all customers. These gaps in coverage of manufacturers, components and customers give rise to a legitimate grey market opportunity.

469. Dr Findlay identified the characteristics of a successful sub distributor. The first characteristic would be a specialist in a component category or a customer segment. Secondly, a successful sub distributor would invest in stock and staff in order to have stock available. Sub distributors regularly speculatively purchased stock as they would be trying to anticipate future demand. Therefore, a sub distributor would have to hold stock until the requisite customer demand materialised. Thirdly, a sub distributor would have ongoing relationships with authorised distributors and assemblers in the major European markets. Finally, a sub distributor would need to achieve high margins because of the lack of volume, which was hard to do because of the low margins usually associated with CPUs.

470. As regards the trading behaviour of a sub distributor, Dr Findlay considered that:

(1) it was essential that the components bought and sold were adequately specified. The product description on purchase orders and invoices should be sufficient to enable the parties to the transaction correctly to identify, understand and price the component. If the sub distributor used the full product code both parties to a transaction would know the technical details of the product because mainstream manufacturers published complete technical specifications for every product. For example, and "Intel P4 3.0 GHz CPU SL 7Z9" identified the processor. However, a buyer needed to know whether the product was in "Boxed" or "Tray" form. To receive it in the wrong form would render it practically useless to most buyers.

(2) There would be a thin spread in prices from the manufacturer to the distributor and assembler.

(3) There would be short deal chains. The addition of a party to deal chain would dilute the already low profit margins of parties further down the deal chain. Dr Findlay did not expect to see long deal chains i.e. with more than four parties in a deal chain.

471. *Distribution of obsolete/niche components.* Dr Findlay considered that this was a small business opportunity, although a potentially profitable one. However, he did not think that in 2006 the Intel chips were obsolete or niche products and that therefore this category did not apply in the context of the present appeal.

472. *Providing an emergency supply of components.* This arose where assemblers underestimated the demand for components. In such cases, and assembler would seek an "emergency supply" of components from the component manufacturer or an authorised distributor. When the component manufacturer or authorised distributor was unable to supply the products, an assembler would contact other authorised distributors to supply the necessary components. However, authorised distributors may not always have those components in stock. Usually the chain would be as follows: a manufacturer selling to an authorised distributor, which would sell to a sub-distributor, which would, in turn, sell to an authorised distributor or assembler.

473. The characteristics of a successful emergency supplier as regards investments in stock and staff, ongoing relationships with authorised distributors and assemblers and high margins were similar to those in respect of successful sub distributors.

474. The trading behaviour of successful emergency suppliers as regards adequate specification of the components, market prices, short deal chains and the volume of components traded were the same as for a successful sub distributor.

475. In Dr Findlay's opinion, the deal chains in the current appeal did not indicate the transactions taking place in the context of an emergency supply of components. They did not include the manufacturer or an authorised distributor and the deal chains seemed too long.

476. *Off-loading excess inventory.* Where an assembler or authorised distributor overestimated demand for components, it may wish to sell the excess inventory. Alternatively, the excess supply may be caused by a manufacturer releasing an

updated product with the result that the assembler finds that its customers no longer wished to purchase the product containing the older component. An assembler or authorised distributor may sell excess stock to its competitors. However, it would normally only do so through brokers because of competitive rivalries.

477. Dr Findlay identified the characteristics of successful distributors of excess stock. The distributors would have ongoing relationships with authorised distributors and assemblers -- the catalyst for offloading excess inventory came from assemblers all their authorised distributors as described above. Secondly, there would be back-to-back transactions. The intermediary would not usually take physical custody of the stock and it would be sold by the supplier to the intermediary and then on to the customer. The transaction would take place in a short space of time. Because little value was added in these situations, the margins would usually be low.

478. The trading behaviour of successful distributors when offloading stock would require adequate specification of the components to be bought and sold -- as described above in respect of sub distributors. Secondly, the components traded between assemblers (via intermediaries) would have to be of use to assemblers, suggesting that they were more likely to be openly available standard components than obscure or specialist components. Successful distributors would always seek the best possible price for components in order to obtain the best margin. Short deal chains would be expected. The volume of components traded would be consistent with the number of components on the market.

479. Dr Findlay considered that the deal chains in relation to this appeal were not consistent with a successful seller of excess inventory. The deal chains were too long and the exporter's margin (up to 8%) was high. In addition, a large number of deals seem to happen within a short period of time, which Dr Findlay did not think was consistent with offloading excess inventory.

480. *Arbitrage.* Component manufacturers were under no obligation to price their components in a uniform way across different countries. They simply charged what they believed each market would bear. Consequently, it was occasionally possible to procure components more cheaply in one country than another. Where the difference in price was sufficiently large, distributors in country A (the more expensive country) would seek to procure components through a distributor in country B (the cheaper country) rather than through the component manufacturer in country A.

481. Dr Findlay explained the broking was a sub activity of large authorised dealers. The vast majority of arbitrage was amongst authorised dealers, not sub distributors.

482. The characteristics of a successful company exploiting an arbitrage opportunity would involve brokers inter-mediating between distributors located in different territories; they would trade in standard components and would have ongoing relationships with authorised distributors and assemblers.

483. As regards trading behaviour, the commercial behaviours would, in respect of arbitrage, be similar to those in relation to sub distributors. Of particular importance

in this context was a requirement for short deal chains. Dr Findlay did not expect to see three UK-based companies involved in trading in a genuine arbitrage situation. He considered it unlikely for a small UK company, effectively run by one person, to be able to acquire many thousands of Intel chips within a period of a few days and to be able to export them if an authorised distributor was not involved.

484. Dr Findlay considered the total value of the legitimate UK grey export market in 2006. He estimated that total value for the legitimate UK grey market in Intel CPUs of £13.9 million. He estimated a total legitimate grey market for exports in Intel CPUs of £1.4 million. He had compiled a list of the main UK distributors from various sources including his own knowledge.

485. He estimated the global market for Intel CPUs as £13.17 billion. 34.9% of this global market was sold through distribution i.e. £4.597 billion of Intel CPUs were sold globally through distribution. The UK was a small proportion of the overall market constituting approximately 2.6%. That resulted in £122 million by value of Intel CPUs being distributed by distributors in the UK. His estimate of the grey market was 6% of that amount i.e. £7.3 million. A typical distributor would export around 19% resulting in a total figure of £1.4 million of Intel CPUs being exported.

486. In the present appeal, in 03/06 and 06/06 the Appellant exported Intel CPUs worth in excess of £1 million. In Dr Findlay's view it was unreasonable that such a large proportion of the export market would be exported by a small company when compared with what was likely to have been exported by much larger distributors. In addition, his estimate of £1.4 million of exports of Intel CPUs was an annual estimate -- the Appellant's figures related only to 2 months.

487. Dr Findlay also carried out research into imports of grey market Intel CPUs to individual European countries in 2006. He estimated the grey market imports of Intel CPUs into Switzerland in 2006 as £0.4 million, with a monthly total of £35,000. The corresponding monthly figure for the UK was £362,000.

488. In Dr Findlay's view the volume of exports by the Appellant (and imports into Switzerland) were not reasonable by reference to Dr Findlay's estimated calculations.

489. Dr Findlay confirmed that Intel released its price list for CPUs periodically on its website. It is from this central list price the discounts were negotiated by Intel's direct customers (assemblers and authorised distributors).

490. Dr Findlay provided to table setting up the typical deal chains he would expect to see in order to exploit legitimate grey market opportunity, as follows:

The legitimate grey market opportunity	**Sub distribution**	**Distribution of obsolete/niche components**	**Excess inventory**	**Emergency supply**	**Arbitrage**

The optimal typical deal chains for this opportunity	Manufacturer ↓ AD ↓ Sub distributor ↓ AD/Assembler	Manufacturer ↓ AD ↓ Obsolete/niche component distributor ↓ Assembler	Manufacturer ↓ Assembler/AD ↓ Broker ↓ AD/Assembler	Manufacturer ↓ AD ↓ Sub distributor ↓ AD/Assembler	Manufacturer ↓ AD(country B) ↓ AD(country A) ↓ Assembler

491. In summary Dr Findlay offered the following expert guidance:

(1) if the product description, on the invoice or purchase order, was insufficient to identify the unique component, then a normal business man would be unable to price the component. This provided evidence that the trades did not represent part of the legitimate grey market;

(2) if the price was significantly different (e.g. more than 20%) than the Intel CPU list price then it could be concluded that the businessman was not able to price his, or her, products correctly. If this was observed across a significant number of deal chains then it was possible to conclude that the businessman was not acting in a commercial manner and may not be part of the legitimate grey market in CPUs;

(3) if a company was exceeding the projected legitimate grey market exports in CPUs from the UK it was highly likely that the company was operating in another market than the UK legitimate grey export market in CPU components; and

(4) if the deal chains examined showed significant repeating patterns (in sale price, volumes and profit margins) and did not conform to typical deal chains as described above, it was possible to conclude that the company was not operating in the legitimate grey market. Additionally, if prices at the beginning of a "back to back" deal chain were successively and repeatedly different from the price achieved by the last participant then one could conclude that the earlier participants in the deal chains were behaving un-commercially, in that they did not achieve the available prices in the market place at that time.

492. As explained above, high profits were difficult to achieve in the electronic components distribution industry. In a low margin business such as distribution, Dr Findlay considered that it was important to have some form of competitive advantage so that both white and legitimate grey market distributors had responded by

demonstrating a specialism such as components or customers. He expected a company in the legitimate grey market to demonstrate the following characteristics:

(1) large multinational distributors have the capacity to obtain volume discounts from component manufacturers. This advantage was complemented by the infrastructure and scale to sell high volumes of standard components at low cost;

(2) sub distributors often aspired to authorised status. Without the volume discounts and scale of an authorised distributor, sub distributors often differentiated themselves by targeting a particular product category to offer a superior stock availability in that category. Sub distributors also often filled gaps in terms of customers not adequately served by authorised distributors;

(3) obsolete/niche distributors succeeded by selling very niche (sometimes obsolete) components to customers who still have a need for that component to maintain older equipment. The critical success factor of obsolete/niche distributors was their product or market specialism;

(4) some distributors focused on excess inventory and systematically purchased stock from assemblers for resale. Their expertise lay in the knowledge of what prices could be achieved, where to purchase excess stock and when to sell. This was complemented by warehousing facilities which allowed decisions on when a sale should be made;

(5) other distributors supplied stock on short timescales as emergency supply. High margins were possible for distributors who could supply an assembler with stock at short notice. This legitimate grey market opportunity required expertise in sourcing or warehousing supply in times of high demand;

(6) arbitrage: a proportion of some distributors' revenue might be derived from sourcing stock from low-cost locations, authorised distributors or assemblers and selling it to high cost locations. Warehousing facilities allowed the distributor to decide when to sell a product; and

(7) brokers tended to be small entrepreneurial companies run by individuals with extensive sales experience in electronic components and CPU distribution. Generally, in all of the above legitimate grey market opportunities, the lack of a warehouse capability would limit the ability of a broker to regularly supply assemblers with components of the right type. It therefore limited the revenue that a typical broker could achieve. Dr Findlay noted that demand did not always come at the same time and therefore a broker needed to store some components with which to supply customers.

493. Dr Findlay considered the back to back dealing, as seen in the present appeal, did not fit with normal broking activity. In his view, most broking actually occurred within the authorised distributors. They had large warehouses and constant supply.

494. In assessing whether a trader was operating in the legitimate grey market, Dr Findlay summarised his views as to whether a company was addressing the five grey market trading opportunities listed above.

495. First, as regards sub distribution, if the Appellant was not holding stock and undertook "back-to-back" trades in its deal chains then it could not be addressing the sub distribution opportunity and was likely to be broking.

496. Secondly, as regards obsolete/niche distribution, if the Appellant did not take physical custody of stock in any of the deal chains examined, then it was unlikely to be addressing the obsolete/niche distribution opportunity. Furthermore, in this context, Dr Findlay would expect to see an obsolete/niche component distributor holding stock for a long time as this would be required to trade in low turnover products. Intel products were not niche, although some of the older Intel products, which were no longer being manufactured, are obsolete.

497. Thirdly, as regards excess inventory, Dr Findlay expected to observe broking fees being paid to assemblers in order to dispose of excess stock. He expected to see deal chains with assemblers at the beginning and end of the chain. He would also expect the Appellant to demonstrate significant industry relationships with assemblers and authorised distributors in order consistently to source saleable components. He would also expect the Appellant to minimise the length of the deal chains in order to maximise the profit available.

498. Fourthly, as regards emergency supply, Dr Findlay would have expected to see significantly higher profits than the industry average ones exhibited by the Appellant. Higher profit margins are possible where and assembler may have shut an assembly line due to lack of an essential component.

499. Finally, as regards arbitrage, this was the grey market opportunity often addressed by a broker. Brokers operating in the arbitrage market were incentivised to minimise the deal chain length through direct relationships with assemblers and authorised distributors. Excessive deal chain lengths and the lack of relationships with assemblers and authorised distributors in other territories would suggest that the Appellant was not operating in the legitimate grey market in either electronic components or CPUs.

500. As regards some of the deals undertaken by the Appellant in the period 06/06 (Deal 1 and deal 2 and 2a), Dr Findlay considered that the description of the CPUs on the invoices was inadequate. The invoices referred to “P4 3 GHz 800”. Intel would have a number of CPUs on its price sheet under this description which would all have different prices. It would not be possible to put a price on the product from this description. In cross-examination, Dr Findlay accepted that there may have been prior telephone discussions in respect of particular trades, but said that if there had been a dispute and the wrong CPUs have been delivered the Appellant would have put themselves at commercial risk.

501. Dr Findlay also commented on the fixed mark-ups made by HKS and Churchill. These did not make sense to him. It showed that the companies concerned were not having commercial discussions.

502. Mr Young in cross-examination asked Dr Findlay to clarify his relationship with PwC. Dr Findlay explained that he was an independent consultant who was contracted to PwC. It was his evidence and his view is that were being expressed. PwC was billing HMRC and he was billing PwC. Mr Young suggested that Dr Findlay may be conflicted because PWC was giving advice to traders in 2006 in the mobile telephone or CPU trade sectors. Dr Findlay had been unaware of this until that week and had not been part of the discussions between PwC and the grey market trader. In his view he was not conflicted.

503. Mr Young also referred Dr Findlay to an e-mail from Mark Howard of PwC to Anthony Elliott-Square, the Chairman of the Federation of Technological Industries ("FTI"). Dr Findlay was unaware of the FTI and said that the main trade body in the UK was the AFDEC. The e-mail related to a BBC television programme concerning carousel fraud. Dr Findlay said that he was unaware of this e-mail and, in any event, it came from the tax department of PwC and that he had never worked in the tax department. In addition, his statement was independent of PwC.

504. Dr Findlay emphasised that his witness statement was his expert evidence and not that of PwC. He was an independent expert witness and his duty was to the Tribunal.

505. In our view Mr Young failed to establish that there was any conflict of interest in Dr Findlay giving expert evidence. The fact that PwC may have advised traders in the mobile telephone and CPU sectors did not in our view establish any conflict of interest in relation to the Appellant. In the same way we could see no conflict of interest in relation to PwC's communications with the FTI. We accepted Dr Findlay's assurance that he was, in any event, unaware of these communications until very recently.

506. Mr Young asked Dr Findlay if there was any reason why, when PwC were talking to the FTI, the information contained in Dr Findlay's report was not highlighted to the FTI. Dr Findlay replied that all the information in his report was publicly available data. He would expect a businessman to have some basic knowledge of who the competitors and the major suppliers in the industry were. Mr Young suggested that although the information may be publicly available HMRC had commissioned him to provide a report because it was something out of the ordinary and they needed an expert. Dr Findlay agreed. He confirmed that PwC will be charging HMRC approximately £70,000 for his report and he himself was being paid witness fee of £1000 for his appearance. However, he did not think it was necessary to pay that amount in order to access the underlying information. In addition, those working in the industry built up expertise which gave them the necessary knowledge. Mr Young suggested that not everybody knew where to look for publicly available information and in reality lay people have to pay for it. Dr Findlay disagreed. To trade in the industry it was necessary to know what you are doing. That knowledge came from experience, or reading newspaper articles, talking to people researching the numbers, finding out what your competitors and your suppliers are earning in terms of profits etc. That was the behaviour of a reasonable businessman with expertise in this particular area.

507. Mr Young questioned Dr Findlay in relation to the grey market opportunity where excess inventory was offloaded by assemblers or authorised distributors. He suggested that it was hardly surprising in that context that back-to-back trading would occur. Dr Findlay stated that he was not asserting that broking did not occur, but it was necessary, for it to be commercially successful, to have relationships with manufacturers, assemblers and authorised distributors.

508. Mr Young suggested that back-to-back dealing could actually lower costs because the storage costs would be less. Dr Findlay admitted that he was not familiar with the operations of freight forwarders. He did not accept that the longer CPUs were stored in secure conditions there would be a greater cost. He said that Intel CPUs had an open market price which was often defined by Intel's prices. Prices generally tended to go down, so what a person was prepared to pay for a CPU would not be dependent on the freight forwarding costs. He accepted that the faster goods were traded, the higher the net profit but did not accept that that meant that the goods would be traded through many different traders. The length of the deal chains was important and it was also important to traders to have relationships with assemblers and manufacturers because it was not possible to get consistent supply of CPUs without those relationships being in place.

509. Mr Young suggested that Dr Findlay focused only on the cost component of the CPUs themselves and had failed to look at other cost factors such as the costs of freight forwarding and insurance, both of which would vary depending on the length of time the goods were stored. Dr Findlay could not comment on the insurance aspects. Mr Young suggested that Dr Findlay had little business experience and that his main skill was technical. Dr Findlay did not accept this and considered that he had a broader set of skills than specifically technical skills.

510. Mr Young suggested that some of the figures given in relation to Intel's manufacturing may not be accurate. For example, large companies sometimes underestimated the amount of stock that they held. Dr Findlay replied that he had not based the calculations and estimates in his report on stock valuations in Intel's accounts. Mr Young put it to Dr Findlay that it was very difficult to estimate the number of CPUs that were actually manufactured because of the peculiarities of the CPU market. Dr Findlay said that his report simply estimated the size of the market on the basis of his research. Dr Findlay rejected Mr Young’s suggestion that his figures were based on marketing information -- they were based on Intel's accounts. His estimates of the size of the market were not based on figures in relation to the production side of Intel's business. He disagreed with Mr Young's suggestion that he did not know the true volume of manufacturing of CPUs and therefore could not be sure of the size of the grey market.

511. Mr Young suggested that a large number of CPUs entered the grey market from authorised distributors who bought more stock than they needed in order to obtain volume discounts from Intel. Dr Findlay accepted that this did happen and that an authorised distributor could sell to anyone in the world. Dr Findlay, however, thought it was unlikely that trades would go through a chain of four or five UK companies. He

also thought that authorised distributors would sell locally and that although some sales may be made internationally this would not be typical.

512. Mr Young challenged Dr Findlay on the basis that he did not know how many CPUs were produced by Intel in the first place and it was therefore very difficult to work out how many could end up on the grey market. Dr Findlay did not accept this. He had made an estimate based on Intel's revenue. He could use this as an estimate of the size of the global market in CPUs. He had broken that down to an appropriate market for UK exports.

513. As regards Intel's price list, Mr Young suggested that no one paid full list price. Intel CPUs were sold in a free market and that whilst Intel's list price may be a starting point, the market determined the price based on discounts and many other factors. Therefore starting with a price that no one paid, Dr Findlay's data was bound to be flawed. Dr Findlay accepted that discounts were given off the list price and these tended to be discounts given to authorised distributors and assemblers of up to 20%. Dr Findlay stated that Intel would sell to an authorised distributor giving it a discount for volume. The distributor, however, would want to make its own mark-up and their price may come back towards what the Intel list price would be on the open market place. Therefore, in the context of the grey market, the lowest price at which goods could be sourced will be those from an authorised distributor. Therefore one way of describing the minimum price in the market place might be to calculate the Intel list price minus (at the very most) 20% plus 6 - 7% (the authorised distributor's mark-up).

514. In addition, when a new CPU was introduced by Intel the price of earlier models would fall. Mr Young suggested to Dr Findlay that since there was typically a two year lead-in time in the design of a new CPU, Intel would wish to off load older versions of CPUs before launching the next version. Dr Findlay suggested that Intel may even destroy, although there was no strong evidence of this. Dr Findlay indicated that when a new CPU came onto the market Intel would reduce their list price for old CPUs. Mr Young queried Dr Findlay's suggestion that CPUs might be destroyed by Intel and asked Dr Findlay whether it was possible to be sure of that. Dr Findlay said that he could not be sure of that and said that his statement was "slightly over the top".

515. Mr Young suggested that this was a complex marketplace and it was impossible for Dr Findlay to analyse it on the basis of the information available to him. Dr Findlay disagreed with that suggestion. His analysis was based on the revenue earned by Intel rather than on the volume of CPUs which it manufactured.

516. Mr Young suggested that it was more likely that Intel, rather than destroying CPUs, would sell them at a large discount through its distributors into the grey market. Dr Findlay consider that Intel would not do so in large amounts and his analysis suggested that the grey export market in the UK was around 6% of all overall CPU distribution.

517. Dr Findlay emphasised that his report was generic and did not examine the detailed position of the Appellant. However, he noted that the Appellant was trading Intel CPUs, it was not an authorised distributor, the deal chains were very long and it

had no relationships with Intel or assemblers. Dr Findlay said that he had examined the Appellant's actual deals and noted that the prices were very close to the list prices for Intel CPUs. In terms of the specification of the products, as regards the 03/06 deal chains in respect of CPUs, the products were accurately specified, although it was surprising that there was no reference to whether the products were boxed or in trays. In the later deal chains (period 06/06) the product description was inadequate and would subject the company to an undue risk in terms of its negotiations. Finally, in terms of the volume test outlined in his report, the volume of CPUs traded by the Appellant seemed excessive when compared with a UK export market, which Dr Findlay estimated to be £1.4 million. Dr Findlay had not examined either the Appellant's accounts or examined its infrastructure.

518. Dr Findlay was cross-examined about his estimate of the size of the UK export grey market in 2006, viz £1.4 million. Mr Young suggested that although Dr Findlay might be able to estimate the number of CPUs sold by Intel, with discounts and possible destruction of goods there was no way of knowing whether this £1.4 million figure was correct. Dr Findlay disagreed with this suggestion and referred to the portions of his report where he explained the basis of his analysis. He accepted that it was an estimate but considered that it was reasonable and was based on what he described as "some pretty good facts", including conversations with the trade distributor body (AFDEC). He denied that it was an educated guess. His estimates of the grey market were not based on adding up the number of CPU transactions that were being traded to a particular distributor or a particular retailer. They were based on the revenues of the distributors in the industry on a yearly basis. Those revenues included all the sales of CPUs and other electronic components and his estimate was derived from that analysis.

519. Mr Young suggested that there was also a market in old Intel CPUs which had been adjusted to operate at a higher speed. Dr Findlay referred to this as "clock acceleration". Mr Young suggested this was another part of the market in CPUs which was so vast and had so many things going on within it that it was very difficult to come up with any clear objective view of the size of the market. Dr Findlay disagreed. "Clocked CPUs" tended to be the preserve of hobby gamers. He disagreed that the size of the market was too vast for accurate estimates to be made. The vast majority of CPUs were put into computers that people bought through retailers. The CPUs were bought by large corporations through distributors. The upgrade market or single CPU market in the retail chain was very small. Boxed distributors (i.e. the sale of boxed CPUs) tended to be used by smaller PC assemblers. Dr Findlay considered that his report covered the vast majority of the market.

520. Mr Young asked whether a typical grey market trader in 2006 would have been aware of the information which Dr Findlay was presenting. Dr Findlay thought that they would have known about the Intel price lists since they were publicly available. They should have had some knowledge of the specifications of different CPUs, which was also publicly available information. He also considered that the market sizing information was available. If one looked at the size of the UK's CPU market and the number of assemblers, one rapidly got to a very small number. That information was available if Dr Findlay had been trading at the time he would thought that there were

not that many customers about. He would also, as a trader, have considered how to obtain a competitive advantage through some form of specialisation or having relationships with manufacturers to ensure supply -- but it was necessary to work in the right industry and know the right people.

521. Mr Young asked Dr Findlay if the Appellant in 2006 had wanted to obtain the information in his report, how much would they have expected to pay for it, Dr Findlay replied that they would have paid the same price as HMRC were paying. However, the information in the report was available at the time. Dr Findlay estimated that the Appellant would have had to pay approximately £30,000 for a report from PWC.

522. In re-examination, Dr Findlay confirmed that part of the reason that he had researched exports of CPU's was because the appeal involved a broker (i.e. an exporter).

523. Dr Findlay noted, on the question of exports, that according to HMRC's data exports of CPUs in the period relevant to these appeals were approximately 5 times the size of the imports and this did not make sense because the UK was not a place where CPUs were manufactured.

524. Dr Findlay, in re-examination, also said that the turnover of the Appellant (£14 million in its first year and £12.5 million in the first eight months of its second year) was such that he was surprised that the Appellant did not appear in any of the research reports that he read such as Euro Partners. £14 million would be a substantial portion of the electronic component distribution market in the UK and would put the Appellant in mid-league table in terms of distributor size. It was noted that the Appellant's turnover was not entirely made up of CPUs.

525. Mr Waddington asked Dr Findlay whether the fact that the Appellant was run by a person who had no experience in this trade sector conformed to his research into the legitimate CPU market place. Dr Findlay confirmed that it did not conform. It was necessary to have relationships to be commercially successful and therefore it was highly unlikely that the Appellant was trading in the legitimate grey market.

526. Mr Waddington referred Dr Findlay to Deal 1 in the period 06/06. The company at the top of the chain, World Tagus, was based on Portugal. Dr Findlay was not aware of an Intel manufacturing facility in Portugal. Dr Findlay considered that in a deal chain of that size he would expect to see larger players in the UK market such as Avnet, Arrow, Dell or Stone. Dr Findlay saw no commercial sense in the three intermediate UK companies (HKS, Churchill and the Appellant) being involved in the chain. The mark-ups were very small and there were 1500 CPUs involved in the deal chain. Dr Findlay considered that the deal chain did not look sensible.

527. Mr Waddington referred Dr Findlay to the fact that the same companies (save that in some cases Corinth appeared at the start of a number of deal chains instead of World Tagus) were involved in a series of deals and asked Dr Findlay for his comments. Dr Findlay thought that this pattern of trading was unreasonable for

economic reasons: he did not expect to see this in the grey market. The deal chains were too long -- manufacturers, assemblers and distributors wanted short supply chains. He did not think that the same repeated pattern of companies appearing in deal chains made sense from a commercial perspective. He also considered the fact that HKS and Churchill repeatedly made the same mark-up indicated that they were not having commercial discussions -- it seemed unreasonable that the prices were the same on each occasion.

528. Dr Findlay did not consider the prices paid in the deal chains to which the Appellant was a party were unreasonable - they were within 5-10% of the Intel list price when converted to dollars at the then prevailing exchange rate. The Intel list price was freely available to anyone accessing Intel's website.

529. Mr Shah was asked by Mr Young about Dr Findlay's evidence. He said that he was totally baffled by what Dr Findlay had said. He would have expected someone giving evidence about a particular industry to work in that field e.g. someone who worked for Intel or who had worked for one of the major distributors. Mr Shah had spoken to Intel directly over the years and he knew how they operated. He also knew how the major distributors operated. As regards Dr Findlay's claim that the grey market was a small percentage (6%) globally, Mr Shah considered this was absurd. On the basis of his conversations with Intel the grey market was 60% of global sales of CPU's. Intel sold CPUs to authorised distributors. The authorised distributors were bound contractually not to sell the CPUs internationally. Therefore, the authorised distributors sold CPUs to associated companies which then exported CPUs exploiting price differentials.

530. Mr Shah noted the comments from HMRC witnesses that there were no manufacturers, such as Intel, or authorised distributors at the end of the deal chains. Mr Shah stated that JIT Computer Distribution sold various products to authorised distributors. Therefore, authorised distributors did not necessarily have to purchase directly from a manufacturer. For example, Ingram Micro and Asbis (Intel authorised distributors) did not necessarily buy directly from Intel in their countries. They bought Intel CPUs from their other offices in various regions in the world. Mr Shah thought that there was a fundamental lack of knowledge displayed by HMRC's witnesses about how the industry worked.

531. On pricing matters, Mr Shah stated that it was well known that the mid-2000s Intel gave Dell computers in the US a multi-million pound marketing/subsidy budget. Dell flooded the market with Intel CPUs at subsidised prices. There were large volumes of CPUs involved -- tens of thousands. Also, when Mr Shah had worked for two PC assemblers, they would overestimate the amount of PCs they were intending to produce in order to buy subsidised CPUs which they then on-sold into the open market to traders at subsidised prices.

532. Mr Shah was surprised at some of the percentage discounts which Dr Findlay said Intel gave to its distributors. He did not think that this information was publicly available and would be known only to distributors.

533. Mr Shah also disagreed with Dr Findlay's evidence that short deal chains made good sense.

534. In cross-examination, Mr Mohammed criticised Dr Findlay for suggesting (a suggestion which he later retracted) that Intel may destroy surplus CPUs. Mr Mohammed considered this destroyed Dr Findlay's credibility. Mr Mohammed said he had no knowledge of the length of the deal chains – he only had knowledge of his supplier and customer.

535. We considered Dr Findlay to be a knowledgeable, objective and credible witness. We do not accept the criticisms of his evidence put forward by Mr Young or by the Appellant's witnesses. We accept Dr Findlay's evidence.

536. In particular, Mr Young's criticism that Dr Findlay's estimate of the size of the CPU market was inaccurate because it was based on Intel's revenues rather than statistics about the number of CPUs manufactured seemed to us to be fallacious. Estimating the size of the market by reference to the revenues of the main supplier seemed to us to be a legitimate method of estimation. Mr Young suggested, at various points in his cross examination of Dr Findlay, that Intel's accounts may deliberately underestimate its stock. This seemed to us nothing more than speculation and certainly no evidence to this effect was presented to us.

537.Dr Findlay's estimate of the size of the grey market in CPUs was simply that: an estimate. Dr Findlay did not seek to suggest otherwise. Nonetheless we considered his method of calculation was reasonable and objective. We accept his estimate as a reasonable approximation of the size of the grey market and, in particular, the size of the UK grey market and the size of the grey export market in the UK.

538. We also accept Dr Findlay's description of the characteristics of different types of successful participants in the grey market. On the basis of Dr Findlay's evidence, we consider that the Appellant's transactions were not transactions which formed part of the legitimate grey market. Legitimate grey market transactions would involve short deal chains. The Appellant's deal chains were lengthy and, in Dr Findlay's, unrealistic. The Appellant (and, in particular, Mr Mohammed) appeared not to trade with authorised Intel distributors, assemblers or with Intel itself. The patterns of the same participants appearing repeatedly in the same positions in the deal chains, making the same or similar mark-ups, was unreasonable.

539. As noted above, we accept Dr Findlay's evidence as to the size of the UK export grey market in Intel CPUs. Dr Findlay estimated that market to be approximately £1.4 million. Even allowing for a degree of latitude in this estimate, it is apparent that the size of the Appellant's transactions over the two months under appeal was disproportionate to the size of the total UK export grey market in Intel CPUs at that time.

540. Our conclusion that, on the basis of Dr Findlay's evidence, that the Appellant's transactions relating to CPUs which form the subject matter of this appeal, did not form part of the legitimate grey market in Intel CPUs does not, of itself, require us to

conclude that the Appellant had actual or constructive knowledge that its transactions were connected with the fraudulent evasion of VAT. Nonetheless we consider our conclusion on this point be part of the factual matrix which we take into account when we reach our decision below.

FCIB Evidence

541. Officer Hancox stated that he had been an officer of HMRC and its predecessors since 1992. Since 2006 he had been part of the MTIC team based at Wolverhampton.

542. He gave evidence relating to information he had obtained from FCIB. The information was obtained from the Dutch authorities. The FCIB bank server files contained two types of information: Datastore and Bankmaster Plus. The Datastore documents primarily comprised the application forms completed to allow potential customers to open an account with FCIB together with supporting documents (e.g. copies of passports, utility bills, bank statements, references and company financial statements). The Bankmaster Plus information was a computer record held by the bank of all the debits and credits to a customer's account with the bank. The records were not a copy of the customer's bank statement, which contains information from both Bankmaster Plus and the E-banking server.

543. In relation to the data derived from Datastore, Officer Hancox examined documentation in respect of 15 companies. The companies were as follows: HKS, Corinth, E Auz Software, Saphire Industries, Futuretech Elect, Churchill, Matrix Europe Ltd, Gold Phone, Silus BV, Orient Motors, World Tagus Trading, ZI Enterprise, The Wireless Warehouse Ltd, Zoom Products Ltd and Texcreations FZE. There were supporting documents for 14 out of the 15 companies. Officer Hancox was unable to trace any documents for Saphire Industries. Five of the 15 companies were UK registered: HKS, Churchill, Matrix Europe, The Wireless Warehouse Ltd and Zoom Products Ltd. The other 10 companies were non-UK registered.

544. Officer Hancox referred to documents relating to HKS. These included a "Letter of good standing" from a company called Transworld Payment Solutions Ltd, signed by Paul Bailey. The documents also included a certificate of incorporation of HKS, also signed by Paul Bailey, certifying the document as a true copy of his certificate of incorporation. There was a copy of a licence agreement for a serviced office used by HKS, signed on behalf of HKS by Mr Farhan Saif. There was a copy of Mr Saif's passport certified as a true copy by Paul Bailey of Transworld Payment Solutions.

545. These documents were typical of those for each company. For example, Corinth, a French company, was owned by a Mr James Niforopulos who was a British passport holder. Mr Niforopulos's UK driving licence had a UK address and was certified as true copy by Paul Bailey (see above). A "Letter of good standing" was also signed by Paul Bailey on behalf of Transworld Payment Solutions.

546. Transworld Payment Solutions also certified documents or provided references for Futuretech, Matrix Europe, Gold Phone, Zi Enterprises and E-Auz Software, even though those companies were variously based in Turkey, the UK, Canada and Australia.

547. Officer Hancox also stated that a "letter of good standing" from Transworld Payment Solutions relating to Zi Enterprises also referred to the applicant on behalf of Zi Enterprises, Mr Ishaq, as someone who already held an account for Saphire Industries. In other words the implication was that Zi Enterprises and Sapphire Industries were related to each other.

548. As regards Corinth, although a French company, as noted above, its owner and director Mr Niforopulos was based in the UK. E-Auz Software was an Australian company and its director, Mr Mike Armstrong, had an Australian address but a UK passport. Silus BV was a Dutch company, but its owner and director had a UK passport and a UK address (in Slough). World Tagus was a Portuguese company but its owner, Jarvaid Sanwar, had a UK passport and a mailing address in Ilford London. Zi Enterprises was a Turkish registered company and one of its two owners, Mr Mohammed Ishaq, was born in Slough and his personal address was in St Paul's Avenue, Slough (also mentioned in Officer Wood's evidence as the address given for the owner of E-Auz Software). Five out of a total of 10 non-UK companies appeared to have a strong connection with the UK either because the owner or director lived in or near London or was a British citizen.

549. Officer Hancox noted that the references for E-Auz Software were given by Zi Enterprises and Saphire Industries -- the two Turkish companies referred to above. The references looked very similar (format and typeface) and the telephone numbers for Zi Enterprises and Saphire Industries were the same except for the last four digits and fax numbers were identical. Both companies used "gmail.com" in their e-mail addresses. As noted above, the reference from Transworld Payment Solutions in relation to Zi Enterprises referred to the co-owner as already having an FCIB account for Saphire Industries.

550. Finally, as regards the Datastore documents, Officer Hancox referred to a letter from Greystone Insurance Services Ltd to FCIB of 26 January, 2006 providing a credit reference in relation to Matrix Europe. Greystone Insurance Services Ltd was the same insurance broker used by the Appellant (see a letter from Greystone Insurance Services Ltd to the Appellant dated 28 April, 2006).

551. In relation to the Bankmaster Plus information, Officer Hancox said that it was often possible to trace all payments and money flows because, very often, all the traders involved in a transaction chain used FCIB. However in this case, not all the traders used FCIB. In particular, the Appellant did not have an FCIB account.. However, Officer Hancox had reviewed FCIB data to ascertain the relevance and value of information held within the records of FCIB relating to the transactions involving the Appellant and other companies involved in a number of the deal chains that took place in 03/06 and 06/06 2006. In other words, he reviewed only those chains in 03/06 and 06/06 in which the Appellant was involved i.e. the alleged contra chains.

552. His witness statement covered only those transactions where he had been able to trace the financial movements through FCIB. He stated that he was able to show circular funds flows, i.e. the same funds moving from one trader through one or more

traders and returning to the first trader. Officer Hancox made it clear that his analysis was a matter of judgement rather than certainty. He prepared deal charts on the basis of his analysis of the information available.

553. Officer Hancox explained his methodology. He had identified the bank accounts relevant to his enquiries and traced the money movements associated with the transactions detailed in the deal chains. The Bankmaster Plus information showed the name and number of the FCIB account, the date of the transaction and the Electronic Banking ("EB") number. The EB number was a unique reference given to each financial transaction and was the same in the receiving and sending bank accounts. It was therefore possible to confirm that the same transaction could be traced between accounts. In some instances two or more transactions were consolidated and this explained why a different figure sometimes appeared on the flow chart from that on the underlying invoice. In some cases it was not possible to follow the payment beyond certain bank accounts and Officer Hancox indicated where this occurred.

554. Officer Hancox commenced the tracing exercise by using the transaction chains produced by Officer Wood as a starting point. In each case Officer Hancox started with Churchill's FCIB account and look for the date and amount of the transaction. Where it was not possible to identify the specific transaction within the Churchill account the next account within the invoice chain was used as a starting point. From this Officer Hancox was able to identify the EB number of the transaction and the account number that the monies were transferred to or from. It was possible to look at those accounts and, using the same EB number, to trace a transaction. Officer Hancox stated that in most deal chains it could be seen that the Churchill FCIB account received money as a transfer from its non--FCIB bank account; these transfers were, in most cases (with one exception -- Deal 3A), in round figures rather than the specific invoice values. Thus, for example, in relation to Deal 2 in 03/06, the amount received by the Appellant was £155,734.50 on 14/03/06 whereas the amount transferred to Churchill's FCIB account from Churchill's Lloyds account was £150,000 on 14/03/06.

555. Officer Hancox, in giving oral evidence, went through a number of flow charts involving a circular flow of funds.

556. The first related to Deal 7 (Invoice 3338) in the period 03/06. The flow chart showed funds moving from E-Future Systems (£111,309.80 on 07/04/06 -- no FCIB account) to the Appellant, from the Appellant (£127,471.05 on 04/04/06 -- no FCIB account) to Churchill's Lloyds account, from Churchill's Lloyds account (£130,000 on 04/04/06) to its FCIB account, from Churchill's FCIB account (£127,174.95 on 04/04/06) to HKS's FCIB account, from HKS (payments of £107,919 on 04/04/06 and £696,000 on 04/04/06) to Corinth's FCIB account, from Corinth's FCIB account (£803,000 on 04/04/06) to E-Auz Software's FCIB account, from E-Auz Software's FCIB account (£835,900 on 04/04/06) to Saphire Industries' FCIB account, from Saphire Industries' FCIB account (£836,000 on 04/04/06) to Future Tech Electronic Components' FCIB account, from Future Tech Electronic Components' FCIB account (£835,650 on 04/04/06) to Matrix Europe's FCIB account and, finally, from Matrix Europe's FCIB account (£928,015 on 04/04/06) to Churchill's FCIB account. In this

instance, the circular flow of funds involved money flowing back to Churchill. It was clear that the funds flowing into HKS from Churchill and from HKS to Corinth were the same funds because when looking at HKS's account it was clear that the funds coming out of the account related to the funds that had just gone in (there was only £13,799.94 left in the HKS account). Officer Hancox performed a similar identification exercise on subsequent payments.

557. The second flow chart related to Deal 1 (Invoice 3332) in period 03/06. The flow chart showed funds moving from Bergmann Associates (£116,749 on 13/03/06) to the Appellant's Lloyds account, from the Appellant's Lloyds account (£126,018.75 on 10/03/06) to Churchill's Lloyds account. Various payments were made in to Churchill's FCIB account. There was some uncertainty as to the source of these payments: in his flow chart Officer Hancox indicated that these monies came either from Churchill's non-FCIB accounts or from Matrix Europe, but in cross examination accepted that there was no evidence that the payment of £460,000 on 13/03/06 came from Matrix Europe. The payments credited to Churchill's FCIB account comprised payments of £120,000 on 10/03/06, £460,000 on 13/03/06 and £150,000 on 14/03/06. Churchill then made payments from its FCIB account (payments of £580,000 on 13/03/06 and £150,000 on 14/03/06) to HKS's FCIB account. The subsequent payments were: from HKS's FCIB account (£154,250 on 14/03/06) to Corinth's FCIB account, from Corinth's FCIB account (£154,200 14/03/06) to E-Auz Software's FCIB account, from E-Auz Software's FCIB account (£154,000 on 14/03/06) to Saphire Industries' FCIB account, from Saphire Industries' FCIB account (£678,000 on 14/03/06) to Future Tech Electronic Components' FCIB account, from Future Tech Electronic Components' FCIB account (£677,500 on 14/03/06) to Matrix Europe's FCIB account and, finally, from Matrix Europe's FCIB account (£649,775 on 14/03/06) to Churchill's FCIB account. In cross examination, Officer Hancox accepted that the payment by Matrix Europe of £649,775 to Churchill was recorded, in the FCIB records relating to Matrix Europe, two transactions before the payment to Matrix Europe of £677,500 by Future Tech Electronic Components.

558. The third flow chart related to Deal 8 (Invoice 3339) in the 03/06 period. The flow chart showed funds moving from the Appellant's Lloyds account (payments of £688,532 on 12/04/06 and £510,068 on 07/04/06) to Churchill's Lloyds account, and from Churchill's Lloyds account (£700,000 on 06/04/06) to Churchill's FCIB account. At this stage the flow chart showed an additional payment being paid by Matrix Europe (the payment being funded by a payment from Future Tech Electronic Components of £472,675 on 04/04/06 which was itself funded by a payment from Saphire Industries of £472,800 on 04/04/06). The flow chart then showed funds moving from Churchill's FCIB account (£692,520.91 on 06/04/06 and £505,744.38 on 04/04/06) to HKS's FCIB account, from HKS's FCIB account (£502,500 on 06/04/06 and £502,500 on 04/04/06) to Corinth's FCIB account, from Corinth's FCIB account (£502,000 on 04/04/06 and £315,000 on 06/04/06) to E-Auz Software's FCIB account, from E-Auz Software's FCIB account (£553,000 on 07/04/06 and £630,000 on 04/04/06) to Saphire Industries' FCIB account, from Saphire Industries' FCIB account (£552,500 on 07/04/06 and £627,000 on 04/04/06) to Zi Enterprises' FCIB account. The FCIB records then showed a payment by Zi Enterprises of £552,000 on 07/04/06 and £626,682 on 05/04/06 outside FCIB (i.e. to another bank). When Officer

Hancox had originally prepared his statement this further payment by Zi Enterprises was untraceable. Recent further disclosure of the Appellant's Lloyds account, however, showed a receipt in the Appellant's Lloyds account on 05/04/06 of £626,669.02 i.e. a very similar amount (a difference of £12.98) to that paid out by Zi Enterprises from its FCIB account on the same date. The statement gave details of the payment as "ACC.NO 040120260." Officer Hancox pointed out that this was identical to Zi Enterprises' account number with FCIB save that that account had an additional digit "5" at the end.

559. Furthermore, the Appellant's same Lloyds bank account statement showed a further amount paid in to the Appellant's account on 07/04/06. The amount was £551,987.02. Again, this was a very similar amount (£552,000) to that paid out by Zi Enterprises from its FCIB account on the same date -- again, a difference of £12.98. Once again, the details given for this payment were the same as those for the payment on 05/04/06 i.e. the same account number as that used by Zi Enterprises for its FCIB account less the final digit "5" at the end.

560. Officer Hancox was asked whether, from his experience, he could explain the difference of £12.98 in respect of both payments. He stated that this amount could well be bank charges made by one of the banks to handle the money transfer.

561. Officer Hancox considered that this information indicated that there was a circularity of money flows from Zi Enterprises to the Appellant.

562. In addition, in his witness statement and his oral evidence Officer Hancox referred to Deal 6 (Invoice 3337) in period 03/06 as evidencing circularity of money flows. The flow chart showed funds moving from E-Future Systems (£137,993.93 on 04/04/06) to the Appellant, from the Appellant (£152,103.75 on 29/03/06) to Churchill's Lloyds account, from Churchill's Lloyds account (£150,000 on 30/03/06) to its FCIB account, from Churchill's FCIB account (151,751.25 on 30/03/06) to HKS's FCIB account, from HKS's FCIB account (£129,075 on 30/03/06) to Corinth's FCIB account, from Corinth's FCIB account (£128,500 on 30/03/06) to E- Auz Software's FCIB account, from E-Auz Software's FCIB account (part of £449,000 [corrected from £449,200 in cross-examination] on 30/03/06) to Saphire Industries' FCIB account and from Saphire Industries' FCIB account (£448,868 on 30/03/06) to HKS's FCIB account. In other words, the money flowed in the circle insofar as it went back to HKS. In cross-examination, Officer Hancox accepted there was some uncertainty about the exact source of the payment from Saphire Industries to HKS although Officer Hancox maintained that the monies from E-Auz Software went to Saphire Industries and that a payment went from Saphire Industries to HKS.

563. There were, therefore, four deal chains in which, in his flow charts, Officer Hancox detected circularity. Only one of these chains (Deal 8) in period 03/06 concerned circularity of money flows involving the Appellant. In respect of other deal chains which form the subject matter of this appeal and which he had examined, Officer Hancox confirmed that there was no circularity of money movements involving the Appellant.

564. Officer Hancox noted that, in the various flows of funds, he had observed minimal net profits and in some cases losses being made by traders in the chains. There was no evidence of manufacturers being involved in any of the money flows nor was there any evidence that any of the money flow chains ended with retailers or with end-users.

565. In cross-examination, Officer Hancox noted that he had examined deal chains without regard to whether there was a tax loss in the deal chain.

566. He confirmed that in relation to Deal 1 in period 03/06 the Appellant had paid Churchill before it received a payment from Bergmann Associates. He also confirmed that there was no allegation of circularity of payments in relation to Deal 2 (Invoice 3333) in period 03/06. Officer Hancox confirmed, in relation to Deal 2, that the Appellant had paid its supplier from its own funds and that there was no allegation that the money used by the Appellant to pay supplier was part of a circular flow of funds. Officer Hancox gave the same confirmations in relation to Deal 4 (Invoice 3335), Deal 5 (Invoice 3336), both Deals relating to period 03/06. In relation to Deal 6 (Invoice 3337) in period 03/06 Officer Hancox confirmed that the Appellant had paid at its supplier using its own funds and that it made such payment before receiving a payment from E-Future Systems. Officer Hancox confirmed that although this deal chain did involve a circularity of funds, the circularity did not involve the Appellant or its direct supplier or customer.

567. In relation to Deal 7 (Invoice 3338) in period 03/06, Officer Hancox accepted that this circularity of payment flows did not include the Appellant or its customer and that the Appellant paid its supplier using its own funds before it had been paid by its customer. Officer Hancox confirmed that he had not checked whether payments received by Matrix Europe from Future Tech Electronic Components were in respect of sales of stock by Matrix Europe to Future Tech Electronic Components in April 2006.

568. In relation to Deal 9 (Invoice 3340) in period 03/06, Deal 1 (Invoice 3355) in period 06/06, Deal 3 (Invoice 3357) in period 06/06 and Deal 3A (Invoice 3357), no circularity of payments was revealed.

569. Mr Young questioned Officer Hancox in relation to his statement that there were minimal net profits and in some cases losses being made by traders in the chains (for example, Deal 5 (Invoice 3336) in relation to payments made and received by Corinth and Silus). He asked whether this contradicted Officer Wood's evidence that there were no losses made in the chains. Officer Hancox did not consider that there was a contradiction because Officer Wood did not have the benefit of the FCIB information when he made his statement. He considered that Officer Wood's statement was correct with the information that he had to hand i.e. the parts of the chains that he was looking at did not contain losses.

570. Mr Young suggested to Officer Hancox that sometimes when looking at the FCIB data it was necessary to apply a subjective interpretation and that different minds might come to different conclusions on the same strands of evidence. Officer

Hancox agreed. Mr Young therefore put it to Officer Hancox that he could not say with absolute certainty that his conclusions were correct and that may be possible to take the same information and applied to different transactions and match them up as well. Officer Hancox thought that that was possible but he believed it was unlikely.

571. In re-examination, Officer Hancox pointed to Deal 1 (Invoice 3332) in period 03/06 as one of the deals where very small gross profits were made (e.g. Corinth made £50 and E-Auz made £200 on a transaction worth £150,000). Officer Hancox did not think such small margins (before bank charges) were commercially reasonable. Another example was Deal 2 (Invoice 3333) and Deal 6 (Invoice 3337) and Deal 7 (Invoice 3338) Deal 8 (Invoice 3339), all in period 03/06, where minimal profit margins were made by various parties. In Officer Hancox's view these payments did not represent genuine commercial transactions.

572. Mr Young cross-examined Officer Hancox on these statements and challenged them as matters of opinion rather than evidence of fact. Mr Young also put it to Officer Hancox that it was not possible simply to analyse one particular deal to work out the true profitability of that deal. Officer Hancox agreed with this proposition on a one-off basis but did not think it was correct in respect of a chain or numerous chains. In relation to split payments, Officer Hancox said that he knew a payment had been split by his analysis of the evidence although he accepted that on some occasions this was a question of judgement rather than strictly a matter of evidence.

Production of diaries and telephone records

573. At a pre-trial review on 18 January, 2011 the Tribunal (Judge Brannan) had directed that the Appellant produce telephone records, diaries and any other evidence of negotiation. During the course of Mr Mohammed's cross-examination it emerged that the Appellant had not complied with this direction (although it had complied with another direction of the Tribunal made on the same date requiring the production of bank accounts). No satisfactory explanation was provided for this failure. Mr Mohammed was therefore requested to produce these documents the following morning. The next day Mr Mohammed failed to produce the documents, explaining that they were stored in his attic which was very full of books and papers. We made it clear that we intended that the direction should be complied with but allowed Mr Mohammed to have the weekend to search for the documents and he duly produced them on the following (final) Monday morning of the hearing.

574. There were two diaries for 2006 -- a red diary and a blue one.

575. Mr Mohammed had exhibited photocopies of the entries in the blue diary to his witness statement. There were very few entries: only four pages (6, 9, 13 and 24 March, 2006). There were other entries on 20, 27 and 28 March, 3 and 10 April, 8 and 11 May and, 16 and 19 June. These other entries were often very brief. The blue diary contained brief shorthand notes of negotiation. There were, however, almost no notes relating to the deals relevant to this appeal (except in relation to 28 March where there appear to be a reference to the software deals with E-Auz). Mr Mohammed explained that he kept notes of deals on scraps of paper and on whiteboards in his office: copies of these notes no longer existed.

576. No copies of the red diary were exhibited to Mr Mohammed's witness statement. The red diary contained considerably more entries than the blue diary and comprised mainly daily checklists or "to do lists".

577. In the red diary there were a number of references (17 in total) to FCIB. An entry in the red diary for 27 March, 2006 contained a reference to a "FC and ABN AMRO CERT OF GOOD STANDING." Mr Mohammed accepted that "FC" was probably a reference to FCIB. Mr Waddington suggested that this indicated Mr Mohammed was considering applying on behalf of the Appellant for an FCIB account. An entry on 6 April, 2006 refers to "INFO TO FCIB." Mr Waddington suggested that this indicated that an application had actually been made and the information sent to FCIB. Mr Mohammed did not deny this. He said that he did not know if he wanted to join FCIB: "I may well have wanted to join them but I don't know if I wanted to there." He stated that the certificate of good standing was something that he would have obtained from his accountants and it would more likely have been for ABN AMRO or UBS "as they were more reputable and more well-known."

578. On 18 April the red diary contains an entry "FCIB + UBS ABM AMRO." The same entry occurs on 19 April. On 24 April the references "FCIB + UBS." The same reference occurs on 25 April, 2, 11, 16, 17, 23, 30 and 31 May, 5 June. There are other references in June 2 UBS and ABN AMRO.

579. We note that two days earlier in his evidence, Mr Mohammed had stated that he did not have any dealings with FCIB.

580. The red diary contained an entry on 16 March which states: "check deals done in absence." Mr Mohammed has spent the three preceding days (13, 14 and 15 March) at CeBIT – the large IT trade fair in Germany. Deal 2 was dated 14 March, 2006. According to the Appellant's mobile telephone records there were no relevant telephone calls about this deal. In cross-examination Mr Mohammed said that he "could" have done the deal face-to-face at the trade fair. Mr Waddington suggested that his secretary (Barbara Smith) did the deal in his absence and handled the relevant instructions and paperwork. Mr Waddington suggested that this indicated that the deals entered into by the Appellant were not genuine commercial deals.

581. As regards the telephone records, there were numerous phone calls which demonstrated that Mr Mohammed did contact his customers and other foreign companies. There were also a number of faxes. The telephone calls were, however, very short -- sometimes lasting only a few seconds. Mr Mohammed said that sometimes he only needed six seconds, particularly as he had already been in contact on MSN. The only issues that a customer or supplier wanted to know would be how many units, how much and when. There were a number of telephone calls to telephone numbers in Turkey, some of the numbers being consistent with those used for those for Zi Enterprises, although the duration of the calls on 30 March (Deals 8 and 9) was very short. Mr Mohammed suggested that the telephone calls were of short duration in order to keep expenses down. However, we noted that the price of many calls was only a few pence.

Legal principles

582. The legal right to a deduction for input tax is enshrined in Articles 167 and 168 of Council Directive 2006/112/EC of 28 November 2006 and in sections 24, 25 and 26 of the Value Added Tax Act 1994.

583. That legal right to a deduction for input tax, however, can be lost where fraud is involved. There is now extensive case law on the subject both before the European Court of Justice and our domestic courts. The position was recently summarised by Lewison J in *Brayfal Ltd v HMRC* [2011] UK UT B6 (TCC) as follows:

> "While Brayfal's appeal has been making its way through the system, the law has been considered by the courts on a number of occasions. It finds its latest authoritative pronouncement in the decision of the Court of Appeal in *Mobilx Ltd v HMRC* [2010] EWCA Civ 517. This decision was handed down on 12 May 2010, a couple of months after the revised decision of the FTT. That case examined the ramifications of the decision of the ECJ in *Axel Kittel v Belgium*; *Belgium v Recolta Recycling* Joined Cases C-439/04 and C-440/04 [2006] ECR 1-6161 ("*Kittel*"). What the Court of Appeal decided was:
>
> 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 fails to meet the objective criteria which determine the scope of the right to deduct. (§ 43)
>
> If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. (§ 52)
>
> The principle 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. (§ 60)
>
> The test 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. (§ 59)
>
> If HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion. (§ 81)

> In answering the factual question, Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focusing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in *Kittel*, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was. (§ 82)
>
> I should also record that it was common ground that these principles should be applied in the light of the circumstances prevailing at the date of the taxable person's own transactions: C-354/03 *Optigen Ltd v Customs and Excise Commissioners* [2006] ECR I-483. "

584. We respectfully adopt Lewison J's summary of the law as a correct statement of the current position. It is worth adding that the standard of proof is the normal civil standard of proof i.e. the balance of probabilities. Both parties accepted that this Tribunal was bound by the Court of Appeal's decision in *Mobilx*.

585. *Brayfal* was a case which involved alleged contra-trading. Lewison J made some additional comments (at paragraphs 16 and 17) on contra-trading which are as follows:

> "The members began their detailed reasoning by saying that the clean chain (in which Brayfal found itself) was created before the dirty chain (§ 138). This was a vitally important point. In order for deduction of input VAT to be withheld, HMRC must prove, having regard to objective factors, that the taxable person, *at the time of his transaction*, knew or should have known that his transaction was connected with fraud. Where the impugned transactions are transactions in the clean chain this presents evidential problems for HMRC. As the Chancellor pertinently asked in *Blue Sphere Global Ltd v HMRC* [2009] STC 2239: how can a trader who is not part of a conspiracy *know* of a fraud before it happens? If there is a regular course of conduct in which the trader knows that his transactions are connected with subsequent transactions that he knows *ex post facto* are fraudulent, there may come a time at which he can be credited with knowledge of the future. But that is not the case that HMRC advanced in this case. Moreover, in the present case, as the members pointed out all Brayfal's transactions were in the clean chain where every member correctly dealt with its VAT (§ 149). Thus the members' findings in §§ 138 and 149 were also relevant to, and supportive of, their rejection of the case based on actual knowledge. In a subsequent passage (§ 153) they said that HMRC were not aware at the relevant time that there was anything amiss with Future; so that Brayfal was "most unlikely" to have been aware. Mr Black drew attention to § 152 in which the members said:
>
> "Question 3 is, in our view, the one the Commissioners have to prove. They have already accepted that Brayfal was not a dishonest co-conspirator ... so must show that it had "the means of knowledge at the

> time of entering into its transactions that they were connected to the fraudulent tax losses"."
>
> He said that the members had wrongly jumped from "no conspiracy" to "means of knowledge" without addressing limb 1 of the *Kittel* test: namely actual knowledge. In my judgment this paragraph must be read in context. The relevant context is that the whole Tribunal had already found that Brayfal was not aware that it was involved in the scheme; and that since the dirty chain was created after the clean chain actual knowledge and conspiracy are likely to be interchangeable concepts. I do not, therefore, consider that on the facts of this case this paragraph reveals a legal error.
>
> The Tribunal members then went on to consider whether Brayfal, through Mr Kibbler, "should have known" that its transactions were connected with fraud. They considered and weighed the evidence. This is what they had said they would do in § 47; which I have already quoted. So they were implementing their self-direction; not adopting a different legal test. One point that they specifically considered was whether they should prefer the evidence of Mr Kibbler to that of Mrs Clifford (who was the main witness for HMRC). The Tribunal judge preferred Mrs Clifford's evidence. But the members did not. They preferred the evidence of Mr Kibbler; and they gave reasons for their preference. Whether I agree with those reasons is neither here nor there. They were questions of fact for the FTT.
>
> The essence of contra-trading is that transactions in the clean chain are used to mask transactions in the dirty chain. There is no fraud in the clean chain. The dirty chain is where the fraud takes place. Accordingly in order for a trader in the clean chain to know or have the means of knowledge that his transaction is connected with fraud, he must either know or have the means of knowledge that the contra-trader is a fraudster; or he must know or have the means of knowledge of the fraud in the dirty chain. The members accepted Mr Kibbler's evidence that he could only check Brayfal's own customers and suppliers (§ 158). In other words they found that he had no knowledge or means of knowledge of the dirty chain."

586. There are two points in relation to Lewison J's additional comments which can be made. First, in the case of alleged contra-trading, HMRC must prove that the broker (the Appellant in this case) had the requisite knowledge (i.e. it must know or should have known) that its transaction was connected to either the fraud in the dirty chain (usually the defaulting trader) or the fraudulent cover-up in the clean chain by the contra-trader. It is not necessary for HMRC to prove that the broker knew or ought to have known of both frauds. In this latter sense (i.e. in relation to the cover up), we disagree with Lewison J's suggestion that there is no fraud in the clean chain. The clean chain is an essential part of the fraudulent contra-trader's cover up. We think it more likely that Lewison J was simply making the point that there is no tax loss in the clean chain. In an earlier decision, *Livewire Telecom Ltd v HMRC* [2009] EWHC 15 (Ch), Lewison J said (at paragraph 102 -3):

> "In the case of contra-trading, therefore, the fraudulent conduct extends to conduct "designed" to conceal or avoid the discovery of a fraud. In

other words the cover up is part of an overarching scheme, and is part of an overall fraud. But whether this is a correct description of the overall fraud depends on the facts. Underlying Mr Anderson's description of the fraud is the *assumption* that there is an overarching scheme. But whether there is such a scheme is for the Tribunal to decide. Mr Anderson's formulation assumes that which it is necessary for HMRC to prove.

In my judgment in a case of alleged contra-trading, where the taxable person claiming repayment of input tax is not himself a dishonest co-conspirator, there are two potential frauds:

i) The dishonest failure to account for VAT by the defaulter or missing trader in the dirty chain; and

ii) The dishonest cover-up of that fraud by the contra-trader.

Thus it must be established that the taxable person knew or should have known of a connection between his own transaction and at least one of those frauds. I do not consider that it is necessary that he knew or should have known of a connection between his own transaction and both of these frauds. If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know. As Millett J put it in *Agip (Africa) Ltd v Jackson* [1990] Ch. 265, 295 (in the context of dishonest assistance in a breach of trust):

"In my judgment, however, it is no answer for a man charged with having knowingly assisted in a fraudulent and dishonest scheme to say that he thought that it was "only" a breach of exchange control or "only" a case of tax evasion. It is not necessary that he should have been aware of the precise nature of the fraud or even of the identity of its victim. A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party, takes the risk that they are part of a fraud practised on that party."

This conclusion is, I think, consistent with what Burton J said in *Just Fabulous* (§ 24):

"*whether or not* Evolution knew of the precise nature of the defaulter chain or of the goods purportedly dealt with in that chain or the identities of the participants in that chain, Evolution *knew of the fraudulent aim of Blackstar* in acquiring, through the off-set on the contra-trading transaction, the opportunity to receive, by such off-set, VAT which it would not be able to recover direct from the Revenue." (Emphasis added)

In other words, if the taxable person knew of the fraudulent purpose of the contra-trader, whether he had knowledge of the dirty chain does not matter."

587. Lewison J's comment concerning "the risk of participating in fraud" must be read in the light of the Court of Appeal's decision in *Mobilx* where it was held that HMRC must show that the Appellant knew or should have known that its transactions

were connected with the fraudulent evasion of VAT. Nonetheless, we do not consider that this affects the main points that Lewison J was making, viz that it is enough for HMRC to prove that the Appellant knew or ought to have known of either one of the two types of fraudulent conduct but that it is not necessary for HMRC to prove knowledge of both.

588. The second point to make in relation to Lewison J's additional comments relates to the observation that the transactions in the dirty chain may (but need not necessarily) occur *after* the transactions in the clean chain. In other words, depending on the facts, HMRC may have to show that the requisite knowledge of the broker in accordance with the *Mobilx* test existed in relation to transactions in the dirty chain which had not yet occurred unless they can prove that the broker knew or ought to have known that it is transactions were connected with a fraudulent cover-up by the contra-trader in the clean chain.

589.The comments of the Chancellor in *Blue Sphere*, to which Lewison J referred, were as follows (at paragraphs 54-55):

> "The tribunal rejected any allegation of conspiracy involving BSG [the broker in the clean chain] or Infinity [the alleged contra-trader]. It rejected the suggestion that BSG had been manipulated. It acquitted Infinity of fraud. If Infinity did not know of the fraud when it happened and was not party to any arrangement that it should happen, how could BSG have known of any fraud before it happened? No amount of due diligence undertaken in respect of Infinity, Universal or Allimpex could have revealed it. And if BSG could not have known, how could there be circumstances from which it could properly be concluded that BSG ought to have known?
>
> In my view it is an inescapable consequence of contra-trading that for HMRC to refuse a reclaim by E it must be in a position to prove that C was party to a conspiracy also involving A. Although the fact that C is party to both the clean chain with E and dirty chain with A constitutes a sufficient connection it is not enough to show that E ought to have known of the fraudulent evasion of VAT involved in the subsequent dirty chain. At the time he entered into the clean chain there was no such dirty chain of which he could have known, nor was the occurrence of such dirty chain inevitable in the sense of being pre-planned."

590. As the Chancellor noted, in that case, both the broker in the clean chain and the alleged contra-trader did not have actual knowledge of the fraud.

591. In *Livewire* Lewison J discussed the evidential problems in appeals where contra-trading is alleged (at page 676):

> "As the tribunal pointed out in *Livewire* there is an evidential or factual difficulty in proving a connection with fraud in a case of contra-trading, *where the contra-trading is not part of an overall scheme to defraud the Revenue*. [Emphasis added] They noted (see (2007) VAT Decision 20533, para 6) that the problem in real life is that there is no

logical connection between the clean and dirty chains. As Mr Scorey said, the connection is an accounting connection in that the alleged contra-trader offsets his input tax in the dirty chain against output tax in the clean chain. But since the whole system of VAT works on the basis of constant offsetting of input and output tax, the implication of HMRC's case is that every taxable person could be connected with every other taxable person. The tribunal went on to say (para 11):

'11. … conceptually there is therefore a problem in understanding what is the fraud about which the Appellant is said to know or ought to have known. If it be the case that Sygnet and Uni-Brand are involved in a fraud in the sense of helping to cover up the missing traders' defaults by arranging for a reduced repayment (Sygnet) or no repayment (Uni-Brand), at least they were a participant in the chain that included the Appellant. But if Sygnet and Uni-Brand were not so involved and the only fraudsters are the missing traders, such missing traders were not involved in any chain that has a logical connection with the chains in which the Appellant is a party, and in any event the tax that was not paid by the missing traders was in most cases due only after the Appellant's deals …'

[108] Similarly in *Calltel Telecom Ltd v Revenue and Customs Comrs; Opto Telelinks (Europe) Ltd v Revenue and Customs Comrs* (2007) VAT Decision 20266, discussing the question of knowledge, the tribunal (Chairman Colin Bishopp) said (para 52):

'52. … It is difficult to see how a trader, entering into a chain of transactions in which every trader accounts correctly for VAT (and which is not tainted for some other reason) could have the means of knowing that it is a device for concealing, or avoiding the consequences of discovery of, another, fraudulent, chain of transactions. Nevertheless it is, we think, possible that a trader could have the means of knowing that, by his participation, he is assisting a fraud. Much will depend on the facts, but an obvious example might be the offer of an easy purchase and sale generating a conspicuously generous profit for no evident reason. A trader receiving such an offer would be well advised to ask why it had been made; if he did not he would be likely to fail the test set out at paragraph 51 of the judgment in *Kittel*.'"

592. HMRC referred to the decision of Briggs J in *Megtian Ltd v HMRC* [2010] STC 840 at 851:

"I do not read Lewison J's analysis [in *Livewire*] of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known.

[35] In the first place, Lewison J was, as he made very clear, addressing the question what had to be demonstrated against an honest broker who was not a dishonest co-conspirator in the tax fraud. In the

present case, the tribunal's conclusion, after hearing oral evidence from and cross-examination of Mr Andreou, Megtian's shareholder and principal manager, was that Megtian knew that the transactions on which it based its claim were connected with fraud: see para 112 of the decision. Participation in a transaction which the broker knows is connected with a tax fraud is a dishonest participation in that fraud: see below.

[36] Secondly, Lewison J acknowledged that in many if not most cases of contra-trading, the clean chain and the dirty chain were likely to be part of a single overall scheme to defraud the Revenue. As he put it, at [109]: 'Indeed it seems to me that the whole concept of contra-trading (which is HMRC's own coinage) necessarily assumes that to be so.'

[37] In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.

[38] Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including *Livewire*, that may be an appropriate basis for analysis."

593. Finally, we should draw attention to the observations of Moses LJ in *Mobilx* in relation to questions of evidence, where he said (at page 1459):

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

connected with fraudulent evasion of VAT. The circumstances may well establish that he was.

[83] The questions posed in *BSG* …by the tribunal were important questions which may often need to be asked in relation to the issue of the trader's state of knowledge. I can do no better than repeat the words of Christopher Clarke J in *Red 12 Trading Ltd v Revenue and Customs Comrs* [2009] EWHC 2563 (Ch) at [109]–[111], [2010] STC 589 at [109]–[111]:

'*[109] Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.*'

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

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

Decision

Application of legal principles to the present appeal

594. HMRC in their Statement of Case and in argument before the Tribunal based their case firmly on the *Kittel/Mobilx* test that: (a) the Appellant's transactions for the two periods in question formed part of transaction chains which were connected with the fraudulent evasion of VAT and (b) the Appellant knew or should have known of

that fact. HMRC argued that the *Kittel/Mobilx* test did not require them to prove that the Appellant was a conspirator and that *Brayfal* did not alter that test. The test was the same for the Appellant's transactions in the context of contra-trading as it was for the one transaction where the Appellant's transaction was part of a tax loss chain (Deal 10). In addition, *Brayfal* was not authority for the proposition that where the transactions in the tax loss chain may have occurred after the transactions in the clean chain this meant that actual knowledge could not be established. Contra-trading was a process which took place over an entire VAT period. The fraud was an on-going process, the exact details of which the Appellant did not need to have knowledge (*Megtian*).

595. Mr Young, for the Appellant, argued, on the basis of the judgment of Lewison J in *Livewire*, that HMRC had to prove that the Appellant knew (or ought to have known) either of the fraudulent evasion of VAT in the tax loss (ie dirty) chains or that it knew (or ought to have known) of the fraudulent cover-up being carried on by the alleged contra-trader (HKS). Mr Young also submitted, relying on comments of the Chancellor in *Blue Sphere* and of Lewison J in *Brayfal*, that HMRC could only prove that the Appellant had actual knowledge of contra-trading if it was a co-conspirator. HMRC had not pleaded (and in their closing statement explicitly acknowledged that they were not arguing) that the Appellant or its directors were co-conspirators. The transactions in the dirty chain took place after the transactions in the clean chain. As a matter of law, in order for HMRC to prove that the Appellant had actual knowledge or means of knowledge that its transactions were connected to the alleged fraud by HKS (or by the defaulting traders) which post-dated its supplies, they must be in a position to prove that the Appellant was a party to a conspiracy.

596. In our view, HMRC must prove (applying the civil burden of proof: on the balance of probabilities) that the Appellant knew or should have known that its transactions were connected with the fraudulent evasion of VAT in accordance with the *Kittel/Mobilx* test. That test must be applied in the light of the facts known or available to the Appellant at the time of the transactions concerned. The Appellant's actual or imputed knowledge cannot be determined using the benefit of hindsight. HMRC must prove, in accordance with *Mobilx*, that the Appellant knew or ought to have known that its transactions *were* connected with the fraudulent evasion of VAT. It is not enough to show that the Appellant knew or ought to have known that there was a risk of its transactions being connected with fraudulent evasion. For example, it is well known that the mobile phone and CPU grey markets were rife with VAT fraud at the times material to this appeal; but it is not enough to say that by trading in the grey CPU market the Appellant ought therefore to have known that there was a risk that its deals would be connected with VAT fraud.

597. Contra-trading is a variation on "simple" MTIC fraud (i.e. "simple" in the sense that in ordinary MTIC fraud transactions the broker's transactions occur in the tax loss chain). All but one deal (Deal 10) in the current appeal is alleged to involve contra-trading. Nonetheless, the *Kittel/Mobilx* test applies to contra-trading in the same way that it applies to simple MTIC transactions. It is important, as Moses LJ observed, that the test should not be over-refined.

598. We have been guided by the reasoning of Briggs J in *Megtian* to the effect that it is not necessary for HMRC to prove that the Appellant knew all the details of the fraud. . As Briggs J noted, Lewison J in *Livewire* was not putting forward a "rigid prescription" to be applied in all contra-trading cases as regards what HMRC needed to prove regarding the knowledge of the Appellant. Therefore, following the analysis of Briggs J in *Megtian*, if HMRC can prove that, taking account of all the circumstances, a broker had actual or imputed knowledge that its transactions were connected with fraudulent evasion of VAT, in our view, they do not have to prove knowledge of the exact nature of the fraud i.e. the identity of the participants, whether the fraud was that of a defaulting trader or that of a contra-trader fraudulently seeking to conceal the dirty chain. From the point of view of a broker its transactions will look very similar regardless of whether the chain in which it participates is a "clean" (ie contra) or a "dirty" (ie tax loss) chain. This is so, in our view, even if the tax loss in the dirty chain arises after the broker's transactions in the clean chain – we accept Mr Waddington's submission that contra-trading is a fraud which takes place over a period of time and that it is not necessary that all the elements of the fraud had been put in place by the time of the Appellant's transactions. If the evidence proves on the balance of probabilities that the broker knew or ought to have known that its transactions were connected with fraudulent evasion of VAT that, in our view, is sufficient.

599. In addition, we consider that the *Kittel/Mobilx* test does not require HMRC to prove that the Appellant was a co-conspirator when arguing, in the context of contra-trading, that the Appellant had actual knowledge that its transactions were connected to fraud. As Lewison J himself noted in *Brayfal*, as regards contra-trading, actual knowledge and conspiracy are likely to be interchangeable concepts. It may well be that a broker, who participates in a clean chain and who has actual knowledge that the contra-trader is concealing the operation of a dirty chain, is likely to be part of a conspiracy. However, in relation to contra-trading, all that HMRC needs to prove, in terms of knowledge, is that the broker had actual knowledge that its transactions were connected to fraud. The existence of a conspiracy may well be an inference (in many cases an irresistible inference) that can be drawn from the existence of actual knowledge but it is not something which, according to the *Kittel/Mobilx* test, HMRC must plead or prove. This is particularly important in a case where there is no single piece of evidence which, by itself, proves that a trader had actual knowledge, but where the totality of the evidence shows that actual knowledge existed. Bearing in mind the warning of Moses LJ in *Mobilx* that the *Kittel* test should not be over-refined, we interpret the comments of the Chancellor in *Blue Sphere* in this manner.

600. Mr Young noted that the comments of the Chancellor in *Blue Sphere* (at paragraphs 54 -55) in relation to the need to prove conspiracy in cases of actual knowledge involving contra-trading were cited without comment by Moses LJ in *Mobilx*. However, in deciding the *Blue Sphere* appeal we consider that Moses LJ plainly applied the standard *Kittel/Mobilx* test of whether the Appellant knew or ought to have known of the connection to fraud. Moses LJ did not suggest that in contra-trading cases involving actual knowledge there was any need to prove conspiracy or that there was any test which was different from that advanced in *Kittel*.

601. It should further be noted that, of the four recent decisions of the High Court or Upper Tribunal which have dealt in detail with the question of knowledge in relation to contra-trading, only *Megtian* involved a case where it was found that the Appellant had actual knowledge that its transactions were connected with the fraudulent evasion of VAT. In *Livewire, Blue Sphere* and *Brayfal* the Tribunal found that the Appellants did not have actual knowledge of the fraudulent evasion of VAT: those cases were decided on the issue of whether the Appellant ought to have known of the connection to fraud. Indeed in *Livewire* and *Blue Sphere* it was also found that the alleged contra-trader was not fraudulent.

602. The comments of Lewison J and the Chancellor in those cases (*Livewire, Blue Sphere* and *Brayfal)* as regards what must be proved to establish actual knowledge are therefore, with respect, *obiter dictum* and are not binding in a case where the Tribunal concludes that the Appellant had actual knowledge. The reasoning of Briggs J in *Megtian* in relation to actual knowledge is binding upon us, subject to any necessary modifications which may be required by the subsequent decision of the Court of Appeal in *Mobilx.* Of those four decisions of the High Court or Upper Tribunal only *Brayfal* was decided after the Court of Appeal's decision in *Mobilx*. In *Megtian* Briggs J refrained from deciding those issues which were going to be considered by the Court of Appeal in *Mobilx*. A review of Briggs J's judgment shows, however, that he applied the test, later confirmed by the Court of Appeal, that HMRC must prove that the Appellant knew or ought to have known that its transaction *were* connected to fraud. Insofar as the reasoning of Briggs J (as to what HMRC must prove in a case of actual knowledge) differs from the views expressed by the learned judges in *Livewire, Blue Sphere* and *Brayfal* it is binding on us and we must apply it. In any event, with respect, we are entirely in agreement with the views expressed by Briggs J. We also note that this Tribunal in *Edgeskill Limited v HMRC* [2011] UKFTT 393 reached a similar conclusion and applied the approach set out in *Megtian*.

603. Mr Young submitted that HMRC had to prove that the tax losses had been allocated to the Appellant and that HMRC had failed to prove this. Mr Young cited the judgment of the Chancellor in *Blue Sphere* (at paragraph 46):

> "Plainly not all persons involved in either chain, although connected, should be liable for any tax loss. The control mechanism lies in the need for either direct participation in the fraud or sufficient knowledge of it. It is important, as the Tribunal recognised in paragraph 131 of its decision, that such tax losses are only used once. Thus having used the tax losses attributable to A.S.Genstar and Wade Tech by allocation to the tax reclaimed by BSG they are no longer available to be allocated to other transactions or claims."

604. We reject this submission. Applying the *Kittel* test we must be satisfied that there has been a tax loss resulting from fraudulent evasion. *Kittel* does not require that the tax loss should equate with the amount of input tax denied, as explained by Moses LJ in *Mobilx* at paragraph 65:

> "The Kittel principle is not concerned with penalty. It is true that there may well be no correlation between the amount of output tax of which

> the fraudulent trader has defrauded HMRC and the amount of input tax which another trader has been denied. But the principle is concerned with identifying the objective criteria which must be met before the right to deduct input tax arises. Those criteria are not met, as I have emphasised, where the trader is regarded as a participant in the fraud. No penalty is imposed; his transaction falls outwith the scope of VAT and, accordingly, he is denied the right to deduct input tax by reason of his participation."

605. We also note the comments of Floyd J in Calltel Telecom Limited v HMRC [2009] EWHC 1081 (Ch) (at parapgraphs 97 to 99):

> "Secondly, none of the statements in *Kittel* suggest that the right is lost only to the extent that tax is lost elsewhere in the chain. It is true that measures adopted by Member States to combat MTIC fraud must be proportionate: see e.g. Netto (supra) at [18]-[23]. Thus irrebuttable presumptions of illegality, for example, are not permitted: *Garage Molenheide Joined Cases* C-286/94; C-340/95; C-401/95 and C-47/96: [1998] STC 126 at [52]. But, once it is established that a taxpayer has, by his purchase, participated in the fraudulent evasion of VAT, it seems to me to be impossible to argue that, by withholding repayment of VAT in respect of that very purchase the taxpayer is being subjected to a disproportionate remedy. In fact, to use the VAT legislation to achieve any benefit from such a purchase seems to me to be wrong in principle.
>
> Thirdly, although fiscal neutrality is a fundamental feature of the system of VAT, and the right of any trader to deduct input tax is an important feature of the system of ensuring fiscal neutrality (see e.g. *Kittel* at [48]), the fiscal neutrality of an individual transaction will, as *Kittel* shows, have to give way to the objective of combating fraud.
>
> It seems to me that the objective of not recognising the right to repayment is not simply to ensure that the exchequer is not harmed by fraud: the objective includes combating fraud and discouraging taxpayers from entering into transactions of this nature. In that context, considerations of fiscal neutrality of the impugned transaction are, it seems to me, beside the point.

606. In any event, it was clear that the tax losses involved in this appeal were significantly greater than the amount of input tax claimed by the Appellant and there was no evidence of improper double counting. Accordingly, for the reasons given by Moses LJ and Floyd J we do not consider that Mr Young's allocation argument was well founded.

607. In approaching the issues in this appeal we have borne in mind the words of Christopher Clarke J in *Red 12 Trading Ltd v Revenue and Customs Comrs* [2009] EWHC 2563 (Ch) at [109]–[111], [2010] STC 589 at [109]–[111]:

> "[109] Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the

> tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it."

Our conclusions on the evidence in relation to actual or imputed knowledge of the Appellant

608. We have already concluded, for the reasons given earlier in this decision, that all the Appellant's transactions which form the subject matter of this appeal in the periods 03/06 and 06/06 were connected with the fraudulent evasion of VAT. Therefore, the remaining issue is whether the Appellant knew or ought to have known that its transactions were connected to the fraudulent evasion of VAT.

609. We have decided that the Appellant had actual knowledge that all of its transactions in the periods 03/06 and 06/06 were connected to the fraudulent evasion of VAT. We consider that the evidence, when looked at in the round and applying the civil standard of proof of the balance of probabilities, strongly supports this conclusion.

610. We reached this conclusion for the reasons set out below. Some of these reasons are more influential than others. We do not base our conclusion solely on any one reason but on all the reasons listed below viewed collectively, bearing in mind the words of Christopher Clarke J in *Red 12 Trading* quoted above. Our reasons and conclusions on the evidence are as follows:

(1) The Appellant was a new company with limited capital. It was run by a director, Mr Mohammed, who had no real experience of IT trading. Nonetheless, in a short period of time the Appellant was able to record a substantial turnover with apparent ease. The Appellant's sales for the period to 31st October 2005 were £14.2 million. Sales in the year ended 31st of October 2006 amounted to £12.4 million (although the Appellant ceased trading after July 2006). All this was achieved essentially by a person with little or no relevant experience in trading in IT components. The help received from Mr Shah and Mr Kahn appeared to be largely confined to identifying suppliers but not (in the main) customers. This turnover was achieved even though Mr Mohammed's business plan (allegedly prepared while he was being "trained" by Mr Shah for 6 months) for the Appellant's business was ditched at a very late stage. We find this hard to credit.

(2) We found Mr Shah's explanation about Mr Mohammed's experience unconvincing. It may well be true that Mr Mohammed was appointed because Mr Shah trusted him, but his attempts to persuade us of Mr Mohammed's relevant experience through being in a business or commercial environment when, in reality, Mr Mohammed's experience was as a teacher and as someone who

worked in IT support for a bank were not persuasive. When pressed in cross examination about his paucity of relevant experience, Mr Mohammed's statement that he worked on a market stall during his youth was unconvincing.

(3) We considered both the business plan and the manner in which Form VAT 1 (taken together with the VAT registration process) was completed to be misleading. We make the following points.

(a) The business plan, prepared by Mr Mohammed and approved by Mr Shah, plainly envisaged the Appellant's business comprising of the purchase and sale of audiovisual equipment, particularly plasma screens. It also envisaged the equipment being sold to domestic end-users, with a particular focus on educational institutions. This proposed business according to the business plan had nothing in common with the business actually undertaken by the Appellant. It is hard to see how, within the space of a month, such a radical transformation could sensibly take place and no credible explanation was forthcoming.

(b) Both Mr Mohammed and Mr Shah in their evidence sought to persuade us that references to the "multimedia" market were wide enough to encompass the Appellant's eventual trade of buying and selling CPUs and software. In context, however, it is plain that the business plan (which included the reference to the "multimedia" market) did not envisage the Appellant trading in, predominantly, CPUs and, to a lesser extent, in software. The document read as a whole is clearly discussing a market opportunity relating to plasma TVs and audio visual equipment (and envisages expansion into OHP's, projectors, faxes, copiers, printers and interactive white boards). It is true that in footnotes there are references to relationships with Ingram Micro and Tech Data (both of which sold monitors/TV screens) but these cannot sensibly be construed to imply that the Appellant would shortly undertake an active trade of dealing in CPUs and software. Moreover, the business plan specifically stated: "We consciously distance ourselves from the satiated IT spheres of trading." In other words, the business plan suggested that the Appellant would not carry out trading in IT products -- a description which would perhaps more obviously be associated with trading in computer equipment and computer components. We considered that the attempts of Mr Shah and Mr Mohammed to persuade us to accept a proposition which was patently unsustainable (viz that the business plan could be said to have envisaged trading in CPUs and software) to be implausible and, in our view, significantly undermined their credibility.

(c) In addition, the business plan indicated that the end-users to which the Appellant would be selling would be "local/national businesses as well as governmental departments." There was no suggestion that the Appellant would be actively exporting computer equipment, as it was shortly to do.

(d) The evidence was that the business plan was intended to be shown to banks, accountants and that it was also shown to Officer Christopher. As noted above, we infer from the evidence that it was shown to Lloyds Bank

and enabled the Appellant to open an account with their Aylesbury branch. In our view, the business plan was intended to mislead the bank as to the real nature of the business which the Appellant intended to undertake.

(e) As regards Form VAT 1, the description of the intended business activities as "multi media trading" is in our view a broad and somewhat vague expression. It is generally used to refer to content which can include, for example, any of (or a combination of) text, video, still images and audio. "Multimedia" can also refer to the devices (such as computerised and electronic devices) used to store and/or display multimedia content. In our view, therefore, the expression "multi media trading" was wide enough to encompass the activities which the Appellant actually undertook, but it was an unspecific and vague description of its proposed undertaking. We note that on 12 December 2004 the Appellant informed HMRC (Officer Sam McCann) that it would trade in, inter alia, CPUs but this was after HMRC requested more information – it was not information which was spontaneously provided.

(f) In response to the question in Box 10: "Do you expect to receive regular repayments of VAT?" Mr Mohammed ticked the box "No". In response to Box 25 the Appellant indicated that it did not intend to sell goods to other EC Member States. We consider these responses were misleading and inaccurate. Mr Mohammed in his evidence accepted that the Appellant engaged in trading in CPUs from January 2005 and it was clear from Officer Wood's evidence that the Appellant was in a VAT repayment position in respect of every VAT return. We do not consider that Mr Mohammed's explanation, that his answers on Form VAT 1 represented his thinking as to the Appellant's business at the time Form VAT 1 was submitted, was credible. The reported turnover in the 01/05 return was £288,036 and in the 02/05 return the turnover rose to £704,088. In both periods (and in most subsequent periods), according to information derived from the Appellant's VAT returns (exhibited to Officer Wood's statement), 100% of its turnover was exported. Its turnover in the first year of trading (the year ended 31 October, 2005) was £14,203,380, according to Officer Wood's evidence. It seems to us inconceivable that, in a period of two or three months from the submission of Form VAT 1 in early November 2004 to the commencement of trading in January 2005, the nature of the Appellant's business should change from being a supplier to domestic customers (according to the answer to Boxes 10 and 25 and the business plan) to a business almost entirely devoted to exports. In our view, therefore, the replies to Boxes 10 and 25 were intended to mislead HMRC as to the true intentions of the Appellant in relation to the conduct of its business.

(g) We note that on 17 January, 2005 the Appellant informed HMRC that it would trade in computer related equipment, including CPUs, and informed HMRC of its intention to export to Africa and North America. However, this was in the context of the Appellant's application (made on 11 January, 2005) to be moved onto monthly returns, the main justification for

which would have to be that it was exporting or making a zero rated supplies. The information about exports was not volunteered by the Appellant and indeed was only supplied after it had been registered for VAT.

(h) In relation to the suggestion that Mr Shah and Mr Khan resigned as directors shortly before the submission of Form VAT 1 in order to conceal their involvement in the Appellant's business, we did not consider that Mr Shah's explanation was convincing. We found him to be evasive on this point. There appeared to be no convincing reason why Mr Shah should resign even if it was accepted that Mr Khan, because of his role as managing director of Matrix Europe, could not remain as a director. He said that his reappointment as a director was on the advice of his accountants, but did not explain the nature of this advice. The coincidence of timing of the resignations and the submission of Form VAT 1 suggested to us that it was more likely than not that the resignations were designed to ensure that their involvement in the business of the Appellant did not emerge until after the Appellant was registered for VAT. Mr Shah said that he had mentioned to JIT Computer Distribution's VAT officer that he was a director of another company trading in the industry but by this time the Appellant had already been registered for VAT.

(i) Accordingly, both in relation to the business plan and the registration of the Appellant for VAT (and its application to be put on monthly returns), we consider that the evidence shows that the Appellant deliberately attempted to conceal and mislead those to whom the business plan was shown and HMRC (in respect of the registration process) regarding the true nature of its business. In our view, this conduct was only consistent with the Appellant being aware that its intended transactions would be connected with the fraudulent evasion of VAT.

(4) The deal chains seem to us entirely contrived. They seemed to have nothing in common with the normal behaviour to be expected in arm's-length trading. We make the following observations:

(a) The Appellant, in both periods under appeal, acted solely as an exporter. Notwithstanding its business plan, the Appellant did not in those periods sell to a domestic customer and did not sell to an end user or authorised distributor.

(b) Except as regards Deal 10, the Appellant had only one supplier (Churchill). It seems to us unlikely that Churchill, and only Churchill, always had the right stock at the best price in what, according to the Mr Shah's evidence, was a competitive market.

(c) The Appellant (and the other participants in the chain) always seemed able to on-sell all the goods which they had just purchased. The Appellant was never left with unsold goods and never had defective stock returned. In a number of cases, the invoices were all dated the same day. To be clear, trading on a back-to-back basis is not of itself indicative of fraud. There are many perfectly legitimate commercial and financial transactions (eg interest

and currency swaps) which involve back-to-back transactions. However, back-to-back trading can be indicative of non-arm's length or contrived trading when taken to together with other factors in the overall factual context and we consider that to be the case in the present appeal.

(d) Moreover, the participants in the deal chains which involved HKS, Churchill (except the Appellant) made fixed profits per unit. Churchill made £0.20 per unit in respect of CPUs in 03/06 and 06/06. It seems to us inherently unlikely that the Appellant was, unknowingly, always prepared to accept a price which left its supplier (Churchill) with precisely the same profit margin on every single deal involving CPUs. It is hard to envisage how this could happen repeatedly between parties bargaining and dealing at arm's length in a competitive marketplace. It should be noted, in this context, that the per unit prices of CPUs varied from deal to deal, but somehow, in these deals, the Appellant always managed to agree a price which yielded its supplier with exactly the same per unit mark-up in deal after deal. This is completely implausible. As Dr Findlay observed, this indicated that the parties were not having commercial negotiations. It was also at odds with Mr Mohammed's evidence about the amount of negotiation that was required to conclude these deals (see, for example, his claim to have negotiated one third off the marked price of CPUs in shops on the Tottenham Court Road). Our conclusion is that there was no genuine negotiation and that the Appellant was fully aware that its purchases from Churchill were contrived.

(e) Although there were only two deals relating to software (Deals 8 and 9), on both occasions Churchill made the same per unit mark-up. The comments in (d) above apply.

(5) As noted earlier in this decision, we considered Mr Shah and Mr Mohammed were not credible witnesses. Even allowing for the natural reticence or wariness of a witness under cross-examination, we were unimpressed with their evidence. Their replies to questions were frequently evasive. They often gave lengthy replies which failed to answer the questions that they were asked. We reject Mr Young's suggestion that their lengthy replies were motivated by a desire, at last, to be able to tell their story. Credible witnesses may well have given lengthy replies but they would have made a more realistic attempt to answer, rather than to evade, the questions put to them. Sometimes their statements were simply implausible. For example, Mr Mohammed said that he did not reply to Officer Wood's letter concerning E-Auz because he did not know Officer Wood. This seemed an implausible excuse (even when taken together with Mr Mohammed's claim that he had previously corresponded with Officer Christopher on the subject). Both Mr Shah and Mr Mohammed sought to persuade us that there was a genuine plan to trade in plasma TV screens and to trade in Africa. No TV screens were ever sold by the Appellant and there was no trade with Africa. We consider that the reason that this was so was because there were no plans to trade in plasma TV screens or to trade in Africa. We have set out above our views on these witnesses' evidence in respect of the business plan and the process by which the Appellant was registered for VAT and permitted to file

on a monthly basis. The truthfulness of these two witnesses was challenged by HMRC in cross-examination. It was plain to us that these two witnesses were untruthful and their evidence was unreliable.

(6) In relation to Dr Findlay's expert evidence, as noted above, we considered Dr Findlay to be a knowledgeable and credible witness. We accept his evidence (which related only to deals involving CPUs and not to Deals 8 and 9 in 03/06). For the reason given earlier in this decision we concluded, on the basis of Dr Findlay's evidence, that the Appellant's transactions were not part of the legitimate grey market. In particular we accept his evidence that the deal chains in which the Appellant participated did not conform to the characteristics which would be expected in the legitimate grey market. We have some doubts as to how much of his evidence would have been within the knowledge or the means of knowledge of an honest trader. However, Dr Findlay's evidence to the effect that the deal chains made no sense in the legitimate grey market would have been apparent to any trader. There seemed no sense to us in goods changing hands, from one trader to another (eg from Churchill to the Appellant and then to the Appellant's customer and in Deal 10 Outernational to the Appellant and then on to the Appellant's customer), with no value being added, but the price being increased by every party involved.

(7) The Appellant argued that it knew nothing about the deal chains and only knew its supplier and its customer. Even if this were true (and, for the reasons given above, we do not think it was) the Appellant gave no credible reason, beyond a vague assertion that its deals constituted "arbitrage", why it was able repeatedly to buy and sell CPUs and software on a back-to-back basis, adding a healthy mark-up, when in real life (as opposed to "MTIC-land") its suppliers and customers could perfectly easily have done business directly. It is, of course, not for the Appellant to prove its case. The onus of proof rests on HMRC. Nonetheless it is hard to credit that the Appellant believed that such transactions were part of the legitimate grey market. As Moses LJ said in *Mobilx* (in comments directed at constructive knowledge but, in our view, equally applicable in cases of actual knowledge) it appeared that the Appellant:

> "... has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reach a large and predictable reward over a short period of time."

(8) Moreover, we accept Dr Findlay's estimate of the likely size of the legitimate grey export market in Intel CPUs. It must, in our view, have been obvious to the Appellant as an active market participant that the size of its transactions in just two months were out of proportion to the expected size of the legitimate grey export market. We consider this supports, but does not by itself establish, our conclusion that the Appellant knew that its transactions were connected with fraudulent evasion.

(9) Furthermore, Dr Findlay also noted that in respect of the Deals in 06/06 the invoices failed to give sufficient information to enable the parties accurately to price the CPUs concerned. Mr Young suggested that the paperwork may have been preceded by other communications which clarified any uncertainty. However, none of these communications appears to have been committed to

writing. Dr Findlay was therefore correct when he asserted that the inadequate descriptions on the invoices left the parties open to commercial risk if the wrong CPUs were delivered. It is hard to imagine parties who were genuinely dealing at arm's length omitting such basic information. It could hardly be suggested that the elementary precaution of recording in writing with sufficient specificity the details of the goods to be bought and sold was an item of information that was not available to or not within the knowledge of the Appellant. This evidence further supports our conclusion that these deals were not genuine commercial transactions but were carried out in the knowledge that they were connected with the fraudulent evasion of VAT.

(10) As regards the diaries and telephone records, we considered that the entry on 16 March, 2006 in the red diary was revealing and gave us a glimpse of how the Appellant's deals were concluded. Mr Mohammed wrote: "Check deals done in absence." As his diary confirmed, Mr Mohammed was at the CeBIT trade fair in Germany when Deal 2 (in the period 03/06) was concluded. There were no relevant calls from his mobile phone, according to the telephone records. Confronted with this evidence Mr Mohammed suggested (somewhat in desperation, in our view) that he "could" have done the deal face-to-face at the trade fair. We think it was improbable that Mr Mohammed would have concluded a deal in such unusual circumstances without being able to remember it. Mr Mohammed was unable to proffer any plausible explanation as to how this deal seemed to have taken place without his involvement. We infer from this that the deal was done without his intervention and was not a genuine arm's length transaction, but rather was contrived for the purposes of furthering a VAT fraud. Moreover, because Deal 2 in 03/06 was typical of a number of other deal chains (other than Deal 10) we infer from this evidence that the other deal chains involving the same UK parties were not genuine arm's-length commercial transactions.

(11) Mr Mohammed's evidence in cross-examination displayed a noticeable disregard for the due diligence undertaken on the companies with whom he was dealing. He suggested, in relation to Churchill, that it was important for a company to have a Dun & Bradstreet report but stated: "coming back with a failure or coming back with a low 16/100 failure score is of no consequence, because it's an extraneous piece of information. If Churchill did not have a Dun & Bradstreet report I would perhaps be more concerned...." Mr Mohammed's view that, because he did not extend credit to Churchill its high risk of failure meant that he could safely trade with the company with such an adverse credit report, strained credibility. The purpose of such a report was surely to assist in establishing the general credibility and legitimacy of a trading partner. A poor credit rating would be a clear warning signal that the supplier might not be a legitimate trader. When questioned by Mr Waddington as to what a delinquency score meant, Mr Mohammed replied : "... To be honest, I don't really know what it means; this is an extraneous piece of documentation...." This led us to conclude that obtaining a Dun & Bradstreet report was mere window dressing.

(12) As regards insurance, Deal 8 in period 03/06 showed the sale of E-Auz software to Zi Enterprises. The deal value was in excess of £1 million, but the

insurance cover was only £400,000. The goods were exported to Istanbul. Were they to be lost, damaged or stolen the Appellant would have suffered a loss in excess of approximately £700,000. Mr Mohammed found insurance to be expensive and calculated there to be a 7% risk of a problem arising. In the circumstances he thought that this risk was worth taking. This does not stand up to commercial scrutiny. Put another way, a 7% risk equates to a one in fourteen (1 in 14.29 to be precise) chance of a problem. Would a reasonable business man risk £700,000 with a one in fourteen chance of losing his money? We very much doubt whether in a genuine commercial transaction a businessman would run such a risk.

(13) As regards E-Auz software (Deals 8 and 9 in period 03/06), HMRC argued that other E-Auz software being dealt in by Matrix Europe at the same time was bogus. We accept Mr Peake's evidence on this point and we also accept that the software that he examined was, more likely than not, obtained from Matrix Europe. The software which Mr Peake examined was different from that bought and sold by the Appellant in Deals 8 and 9. Nonetheless, it was not disputed that the chain of companies involved in Matrix Europe's deal chains in relation to its version of the E-Auz software were the same as those in Deals 8 and 9 (i.e. Corinth, HKS and Churchill), although the software was exported by Matrix Europe to a different customer (Future Tech Electronic Components). We infer from this that it was more likely than not that the software which formed the subject matter of Deals 8 and 9 was also not genuine. We note in the Matrix Europe deal chains involving E-Auz software that the UK parties (ie HKS and Churchill) and the EU party from which HKS acquired the goods (Corinth) were the same as in Deals 8 and 9 in 03/06.

611. As regards Deal 10 we rely on our findings in sub-paragraphs (1), (2),(3),(4)(a),(c), 5 and 6 in relation to our decision that the Appellant knew that its transaction was connected to the fraudulent evasion of VAT.

612. In relation to the FCIB evidence given by Officer Hancox, we do not think that this information was shown to be within the knowledge of the Appellant. It was also conceded by Officer Stone that suspicions about FCIB only became generally known after the date of the transactions involved in this appeal. It is certainly true that Matrix Europe featured in a number of the circular payment flows, but it was not clear what Mr Khan knew or was alleged to have known. The managing director of Matrix Europe was Mr Khan, a director and shareholder of the Appellant. Officer Hancox quite properly admitted that his interpretation of the FCI be evidence required a degree of subjective interpretation. For these reasons, we do not place reliance on the FCIB evidence in reaching our decision.

613. Mr Khan remains a somewhat obscure figure in this appeal. As noted above, Matrix Europe dealt in E-Auz software and featured in the circular payment flows which formed part of Officer Hancox's evidence. Mr Khan did not appear as a witness and did not give evidence in this appeal. It was not therefore possible to hear his version of events or his explanation of his involvement with the Appellant and of the cash flows examined by Officer Hancox, nor was it possible for his evidence to be tested in cross-examination. We therefore draw no conclusions or inferences in

relation to Mr Khan and his involvement, except as regards E-Auz software as described above.

614. HMRC invited us to draw adverse inferences from the failure of the Appellant to produce its telephone records and Mr Mohammed's diaries in accordance with the direction of the Tribunal. No satisfactory explanation for the failure to produce these documents was proffered by the Appellant. We readily accepted Mr Young's assurance that he was unaware of the direction (Mr Young was not present at the pre-trial hearing at which the direction was made). It was unclear to us why there had been a failure to comply with the direction. It is possible that there was a simply failure of communication between the Appellant and its solicitors. In the circumstances, we thought it was unfair to draw any adverse inference from the Appellant's failure to comply with the direction.

Conclusion

615. We have therefore concluded that in respect of both periods under appeal the Appellant knew that, by its purchases, it was taking part in transactions connected with the fraudulent evasion of VAT. HMRC have proved that the Appellant's state of knowledge was such that its purchases were outside the scope of the right to deduct input tax in accordance with the judgment of Moses LJ in *Mobilx*. We therefore dismiss the appeal.

616. In accordance with an earlier direction of this Tribunal, Rule 29 of the Value Added Tax Tribunals Rules 1986 applies to the costs in relation this appeal. We reserve our decision with regard to costs. We direct that HMRC submit their application for costs, if they intend to do so, to the Tribunal and to the Appellant within 56 days from the release of the decision. Any submissions by the Appellant in relation to costs shall be submitted to the Tribunal and HMRC within 56 days after receipt of the Respondents' submissions by the Appellant. The issue shall be determined on the basis of written submissions, unless either party requests a hearing within 14 days of the final date for the submission of the Appellant's written submissions.

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

GUY BRANNAN

TRIBUNAL JUDGE
RELEASE DATE: 22 August 2011

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