TC01472

Appeal number LON/2009/0530

VAT – INPUT TAX – ASSESSMENT – ***HMRC denied input tax claims totalling £206,696 in respect of four transactions involving sales of semi-conductors which resulted in an assessment of £1,501.57 – Was there a VAT Loss? – Yes – Was the loss fraudulent? – Yes – Were the Appellant's transactions connected with the fraud? – Yes - Did the Appellant know or should have known that its transactions were connected to fraudulent evasion of VAT? – Yes the Appellant should have known – Appeal dismissed***

FIRST-TIER TRIBUNAL

TAX

CORACLE VENTURES LIMITED **Appellant**

- and -

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

TRIBUNAL: MICHAEL TILDESLEY OBE (Tribunal Judge)
NIGEL COLLARD

Sitting in public at 45 Bedford Square, London WC1 on 31 May to 3 June 2011 & 6 June to 9 June 2011

Sundeep Singh Virk, counsel instructed by Clark Wilmot, solicitors, for the Appellant

Daniel Margolin counsel instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. The Appellant appeals against two decisions by HMRC. The first decision sent on 30 January 2009 (but incorrectly dated 30 January 2008) disallowed the Appellant's input VAT repayment claim in the sum of £206,696.00 in respect of four transactions in VAT period 07/06. The second decision was an assessment in the sum of £1,501.57 in respect of VAT period 07/06. Thus the total amount of VAT now in issue was £208,197.57.

2. HMRC contended that each of the disputed transactions was connected with the fraudulent evasion of VAT and that the Appellant knew or in the alternative should have known that the transactions were so connected. The Appellant disputed that it had the required state of knowledge.

3. The Tribunal is required to determine the following matters in respect of the disputed transactions:

(1) Was there a VAT loss?

(2) If so, was it occasioned by fraud?

(3) If so, were the Appellant's transactions connected with such a fraudulent VAT loss?

(4) If so, did the Appellant know or should it have known of such a connection?

4. HMRC had the burden of proving on the balance of probabilities all the four above matters in relation to the Appellant's transactions. The Appellant denied knowledge of the supply chains relied on by HMRC to prove that its transactions were part of an overall fraudulent scheme. The Appellant's knowledge was limited to the parties from whom it bought, and to whom it sold. Although the Appellant was unable to advance a positive contrary case in respect of the first three issues, it was entitled to put HMRC to proof of its case. The principal dispute related to the fourth issue of knowledge. The Appellant agreed that it was the knowledge of its director Dr Dilwyn Williams which was determinative of the fourth issue.

Overview of MTIC Fraud

5. The words of Moses LJ in *Mobilx Limited & Others v The Commissioners for Her Majesty's Revenue & Customs* [2010] EWCA Civ 517 at para.1 provide a succinct overview of the scale of missing trader intra-community (MTIC) fraud:

> "For many years, Her Majesty's Revenue and Customs (HMRC) have attempted to combat "missing trader intra-Community" VAT fraud. It is notorious that the trades in bulk mobile phone and computer chips are especially susceptible to that type of fraud. Latest published estimates (*Measuring Tax Gaps*, December 2009) disclose potential losses in 2005-2006 of up to £5.5 billion and in 2008-2009 of up to £2.5 billion. Lord Hope described the fraud as a "sophisticated attack

on the VAT system", a "pernicious stratagem" and was of the view that Member States were justified in making use of "every means at their disposal within the scope of the Sixth Directive to eradicate it" (*Total Network SL v HMRC* [2008] UKHL 19 [2008] STC 644 § 6)."

6. MTIC fraud exists in two main versions, the so called "classic" variety and the "contra-trading" variety. The judgment of Christopher Clarke J in *Red 12 Trading Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2009] EWHC 2563 (Ch) at paras. 2-7 sets out a useful exposition of the way the fraud works:

> "2. The classic way in which the fraud works is as follows. Trader A imports goods, commonly computer chips and mobile telephones, into the United Kingdom from the European Union ("EU"). Such an importation does not require the importer to pay any VAT on the goods. A then sells the goods to B, charging VAT on the transaction. B pays the VAT to A, for which A is bound to account to HMRC. There are then a series of sales from B to C to D to E (or more). These sales are accounted for in the ordinary way. Thus C will pay B an amount which includes VAT. B will account to HMRC for the VAT it has received from C, but will claim to deduct (as an input tax) the output tax that A has charged to B. The same will happen, mutatis mutandis, as between C and D. The company at the end of the chain – E – will then export the goods to a purchaser in the EU. Exports are zero-rated for tax purposes, so Trader E will receive no VAT. He will have paid input tax but because the goods have been exported he is entitled to claim it back from HMRC. The chains in question may be quite long. The deals giving rise to them may be effected within a single day. Often none of the traders themselves take delivery of the goods which are held by freight forwarders.
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> 3. The way that the fraud works is that A, the importer, goes missing. It does not account to HMRC for the tax paid to it by B. When HMRC tries to obtain the tax from A it can neither find A nor any of A's documents. In an alternative version of the fraud (which can take several forms) the fraudster uses the VAT registration details of a genuine and innocent trader, who never sees the tax on the sale to B, with which the fraudster makes off. The effect of A not accounting for the tax to HMRC means that HMRC does not receive the tax that it should. The effect of the exportation at the end of the chain is that HMRC pays out a sum, which represents the total sum of the VAT payable down the chain, without having received the major part of the overall VAT due, namely the amount due on the first intra-UK transaction between A and B. This amount is a profit to the fraudsters and a loss to the Revenue....
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> 5. A jargon has developed to describe the participants in the fraud. The importer is known as "the defaulter". The intermediate traders between the defaulter and the exporter are known as "buffers" because they serve to hide the link between the importer and the exporter, and are often numbered "buffer 1, buffer 2" etc. The company which exports the goods is known as the "broker".
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> 6. The manner in which the proceeds of the fraud are shared (if they are) is known only by those who are parties to it. It may be that A

> takes all the profit or shares it with one or more of those in the chain, typically the broker. Alternatively the others in the chain may only earn a modest profit from a mark up on the intervening transactions. The fact that there are a series of sales in a chain does not necessarily mean that everyone in the chain is party to the fraud. Some of the members of the chain may be innocent traders.

7. HMRC alleged that the Appellant operated as a broker in a classic MTIC fraud. The Appellant contended that it was an innocent trader even if the disputed transactions could be traced back to a defaulting trader.

Overview of the Law

8. Articles 167 and 168 of Council Directive 2006/112/EC provide:

> "167 – A right of deduction shall arise at the time the deductible tax becomes charged.
>
> 168. Insofar as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay: The VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person".

9. Sections 24 to 26 of the VAT Act 1994 enact into UK legislation the right to deduct tax paid on goods and services used for the purposes of business. Thus a trader is entitled to the deduction of input tax it claims.

10. The European Court of Justice ("the ECJ") in the joint cases of *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04) established an exception to the right to deduct when the trader knew its transactions were connected with fraud. The Court stated:

> "51. In the light of the foregoing, it is apparent that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT (see, to that effect, Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-0000, paragraph 33).
>
> 52. It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this

respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

53. By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity' are not met where tax is evaded by the taxable person himself (see Case C-255/02 *Halifax and Others* [2006] ECR I-0000, paragraph 59).

54. As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep* [2004] ECR I-5337, paragraph 76). Community law cannot be relied on for abusive or fraudulent ends (see, inter alia, Case C-367/96 *Kefalas and Others* [1998] ECR I-2843, paragraph 20; Case C-373/97 *Diamantis* [2000] ECR I-1705, paragraph 33; and Case C-32/03 *Fini H* [2005] ECR I-1599, paragraph 32).

55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 *Rompelman* [1985] ECR 655, paragraph 24; Case C-110/94 *INZO* [1996] ECR I-857, paragraph 24; and *Gabalfrisa*, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see *Fini H*, paragraph 34).

56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

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

60. It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void – by reason of a civil law provision which renders that contract incurably

> void as contrary to public policy for unlawful basis of the contract attributable to the seller – causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.
>
> 61. By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct.

11. The Court of Appeal in *Mobilx Limited & Others v The Commissioners for Her Majesty's Revenue & Customs* [2010] EWCA Civ 517 clarified the test in *Kittel*

> "59. The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> 60. The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

The Evidence

12. The Tribunal heard evidence for HMRC from the following witnesses:

(1) Officer David Phillips who carried out the extended verification of the disputed transactions.

(2) Officer Lisa Margaret Wride gave evidence on her dealings with the Appellant prior to the extended verification exercise undertaken by Officer Phillips.

(3) Officer Tatjana Harris who was a member of the Association of Chartered Certified Accountants, and gave her expert opinion on the loan advanced by the Appellant to Sceptre Services Limited.

(4) Allan Coughlin held a Batchelor of Science in Pure Mathematics and was employed by Cardiff University from 1980 until his retirement in 2008. His area of expertise was in electronic engineering. Mr Coughlin was called as an expert witness on semi-conductors and the technical specification of the goods purportedly traded.

13. The Tribunal admitted in evidence for HMRC the following witness statements which were not disputed by the Appellant:

(1) Officer Gerard Paul Marecaux was a VAT assurance officer responsible for the VAT affairs of E Management Solution (Europe) Limited, the alleged defaulting trader for the disputed transactions.

(2) Officer Ghazalah Shah gave evidence on her dealings with E Management Solution (Europe) Limited.

(3) Officer Susan Elizabeth Payiatis gave evidence on her visits to E Management Solution (Europe) Limited.

(4) Officer Ian Webster gave evidence on the background activities of E Management Solution (Europe) Limited.

(5) Roderick Guy Stone had extensive experience of MTIC fraud and gave a statement to provide an explanation of the nature and features of the fraud.

14. Dr Dilwyn Williams and Mr Bleddyn Lewis testified for the Appellant. Dr Williams was a director, shareholder and the controlling mind of the Appellant. Mr Lewis was a friend of Dr Williams. Mr Lewis held a degree in electrical and electronic engineering from Cardiff University. He gave evidence on his enquiries into the semi-conductors which he was asked to carry out by Dr Williams before the disputed deals took place.

15. The Tribunal received seven bundles of documents in evidence. The Tribunal heard the Appeal over eight days starting on 31 May 2011 and ending on 9 June 2011. The Tribunal reserved its decision at the conclusion of the hearing.

The Appellant

Background

16. In 2001 Dr Williams set up an IT consultancy, PL Ventures Limited, after completing his doctorate in mechanical engineering from Cardiff University and working for several years in the IT sector as a sole trader. Dr Richard Griffiths, also a reader at Cardiff University, joined PL Ventures as a co-director in 2003. Dr Griffiths focused on the website and software side of the business and Dr. Williams concentrated on the networking and hardware side. Initially PL Ventures was too small to have trade accounts with big IT hardware distributors, instead it sourced hardware from Sceptre Services Limited. Dr Williams was a close friend of Mr Rayer, the owner of Sceptre Services. Subsequently PL Ventures was able to support its own trade accounts and traded successfully.

17. The Appellant was incorporated on 13 September 2002. Dr Williams was appointed director with Dr Griffiths as company secretary, with each of them having 50 £1 ordinary shares in the company. The Appellant was set up initially to host servers in support of PL Ventures' operations but this did not develop and the company was made dormant.

18. After doing business through PL Ventures, making contacts in the industry and his searches of the International Computer Brokers' (ICB) website[1] Dr. Williams sensed business opportunities in trading CPUs. He and Dr Griffiths decided to start up in this area of trade using the Appellant as the corporate vehicle, which enabled them to keep the trading side of the business separate from the website and software business carried out by PL Ventures. Dr Williams considered that these were two different businesses. PL Ventures was adding value to its services, whereas the Appellant was simply trading a product. Dr Williams acknowledged that the Appellant was operating in a trading sector which carried more risk with a high incidence of fraud than the market in which PL Ventures operated. Dr Williams, however, denied that the high risk of the Appellant's market was the sole reason for keeping the two businesses apart.

Registration and Trading Activities

19. On 29 April 2005 Dr Williams registered the Appellant for VAT with an intended business activity of *general computer hardware and software sales including volume sales to the UK and overseas clients.* Dr Williams, in a questionnaire on the Appellant dated 6 June 2005, described its business activity as *the retail of computer software and hardware to business users as well as wholesale sales of hardware.* At the time of completing the questionnaire, Dr Williams was not fully aware of the distinction between retail and wholesale sales. As far as he was concerned the Appellant sold software and hardware to business users.

20. Dr Williams accepted that in the VAT 1 the expected taxable turnover was recorded as nil but that he estimated a value of £500,000 for sales to other EC Member States. Dr Williams stated that the nil value for taxable supplies was an oversight, and that he could not recall now the determination of the £500,000 value. Officer Phillips accepted that in the VAT 1 Dr Williams was specific from the outset about the Appellant trading overseas in IT products. There was no attempt by Dr Williams to disguise the Appellant's intention to sell overseas. Officer Wride acknowledged that the figure of £500,000 was an attempt by the Appellant to estimate the anticipated turnover for the next 12 months. The mere fact that the actual turnover exceeded this figure was not, in Officer Wride's view, an indicator of fraudulent activity.

21. The questionnaire dated 6 June 2005 stipulated that the Appellant expected to achieve a mark up of five per cent and that it had four potential suppliers and two customers. Dr Williams, however, acknowledged that the Appellant from the outset intended to source the computer chips and components from one supplier, Sceptre Services. Dr Williams had first met Mr Rayer, the owner of Sceptre Services, when he was studying for his doctorate. They became close friends through their mutual interest in sailing. The Appellant's first customer, Square Trading, was obtained via Sceptre Services.

[1] Dr Williams obtained the website address from a Google search.

22. Dr Williams indicated in the questionnaire that the Appellant's start up capital consisted of £110,000 of personal investment, and £250,000 bank overdraft.

23. Around 2006 the Appellant started to trade as well in Apple iPods selling them into Europe, particularly Austria, Germany and Holland.

24. The Appellant submitted VAT returns on a monthly basis, and was a repayment trader until VAT period 08/06. HMRC had agreed to the Appellant making monthly returns. The Appellant's net turnover for the period 06/05 to 12/05 was £1,918,741 with a nil output for period 12/05, and a high of £617,860 for 09/05 period. The net turnover for the following period was £12,334,970 with nil outputs for periods 01/06 and 04/06 and a high of £3,373,380 for 08/06 period.

25. The Appellant's draft accounts for the year ended 31 March 2006 showed that from a standing start it achieved a turnover of in excess of £3.2 million with a gross profit of £142,593[2], distribution costs of £1,253, which related to payments made to freight forwarders, and administration costs of £8,581. The administration costs for 2006, however, were subsequently increased to include £123,505 representing part of the VAT repayment claim which was the subject of this Appeal.

26. The Appellant's accounts for the year ended 31 March 2007 reported a turnover of £11,015 million, a gross profit of £168,136 and administrative expenses of £126,265, which included £83,000 of the disputed VAT repayment claim. Dr Williams was unable to explain why the VAT repayment had been written out of the accounts rather than being recorded as a bad debt in the balance sheet.

27. Dr Williams accepted that a gross profit of £168,136 was a healthy one for a small business. Dr Williams, however, pointed out that the dividend taken from the business by Dr Griffiths and him was £39,000 over two years. In Dr William's view, the Appellant's venture represented a high risk for him for a modest return. According to Dr Williams his life savings were at risk with the large money movements associated with the Appellant's business.

28. Dr Williams said that he gave some thought to the Appellant's rapid and substantial increase in turnover and did find it surprising but he was doing his very best to make the business a success.

29. After viewing a BBC *Panorama* programme on MTIC fraud in August 2006, Dr Williams said that he became fully aware of the extent of fraudulent activity in the wholesale CPU market and decided to cease trading in those products. The BBC *Panorama* was broadcast on 16 July 2006 when Dr Williams was in Malta. Dr Williams insisted that he viewed the *Panorama* programme sometime after the first broadcast on a form of media player. Officer Phillips expressed doubts about Dr Williams' explanation for the Appellant's cessation of trading activities, pointing out that on 29 August 2006 HMRC informed Dr Williams of the extended verification of

[2] The 2007 accounts cited a comparative gross profit of £129,933 for 2006. Dr Williams was unable to explain the variation from the gross profit figure given in the draft accounts

the 07/06 period. According to Officer Phillips, it was also noteworthy that the Appellant did not trade in this sector once HMRC introduced the reverse charge mechanism on specified goods.

30. As a result of Dr Williams' decision not to trade further in CPU goods, the Appellant's turnover was negligible from period 09/06 until 1 February 2008 when it was de-registered for VAT. Officer Phillips subsequently agreed to the VAT registration of Dr Williams' new company (Williams and Gwilliam).

Appellant's General Awareness of MTIC Fraud and contact with HMRC

31. Dr Williams accepted that, from the Appellant's incorporation, he was made aware by HMRC of the risks of fraud in the Appellant's trade sector. Officer Tromans provided Dr Williams with a letter dated 27 June 2005 including VAT Notice 726 – *Joint and Several Liability.* The letter stated that

> "HMRC are still experiencing certain problems with businesses in your trade sector offering commodities regularly involved in MTIC VAT fraud. MTIC fraud may involve all types of VAT standard related goods and services including computer equipment, mobile phones and ancillary items. The current estimate of the VAT loss from this type of fraud in the UK alone is between £1.06 and £1.73 billion per annum."

32. Dr Williams' interpretation of the massive numbers in respect of the losses was that it was due to criminal gangs running dodgy goods. Dr Williams believed that if the Appellant did clean business with trusted customers and suppliers it could avoid the risk of fraudulent transactions.

33. On 6 July 2005 Officer Wride visited the Appellant with a colleague. The purpose of the visit was to obtain a duplicate VAT return for the period ending 06/05. At the visit Dr Williams confirmed that the Appellant was dealing in the buying and selling of boxed units and computer chips. Dr Williams stated that the Appellant would be buying from one supplier, Sceptre Services. At the time Sceptre Services was suspected by HMRC of involvement in MTIC fraud. Officer Wride did not advise Dr Williams of this suspicion. On 26 September 2005 Officer Wride conducted another visit to the Appellant where she explored in more detail the Appellant's business relationship with Sceptre Services.

34. On 7 December 2005 Officer Wride and a colleague again saw the Appellant where they asked about the Appellant's due diligence checks to which Dr Williams replied: "*the usual, Redhill Checks, VRN (VAT registration number) checks online, credit searches and inspection reports*". Dr Williams acknowledged that he knew about the need to carry out commercial checks and contacting Redhill[3]. According to Dr Williams, the Appellant did everything in its powers to find out whether its customers and suppliers were trustworthy. The Appellant was able to get an idea of

[3] Redhill was the HMRC office for the MTIC Validation Team, which provided traders with information on the validity of the VAT registration details of their potential customers and suppliers.

the open market value of the components it traded by conducting searches on the internet.

35. At the meeting on 7 December 2005 Officer Wride advised Dr Williams that she had identified tax losses in the Appellant's deal chains in various periods from June 2005. As a consequence the repayment claim of £68,084 for 11/05 period would not be authorised until she had conducted an extended verification of a selected number of the Appellant's deals. On the 22 December 2005 Officer Wride advised Dr Williams that she had uncovered tax losses exceeding £103,000 in various deals undertaken in the period June to September 2005. Officer Wride reminded Dr Williams of the requirements of VAT Notice 726. On 18 January 2006 Officer Wride authorised a discretionary without prejudice payment of £68,084.29 to the Appellant in respect of its 11/05 claim.

36. Officer Wride confirmed that Dr Williams had been co-operative during her enquiries. Officer Wride indicated that she was satisfied with the due diligence carried out by Dr Williams and that she had no concerns with the Appellant's relationship with Sceptre Services at the time of her enquiries into the Appellant's VAT affairs.

37. Dr Williams agreed that parts of the Appellant's supplies were caught by the requirements of Notice 726. He, however, expressed doubts about whether a semi-conductor would fall within the definition of specified goods in Notice 726, arguing that a semi-conductor was used in electronics and did not meet the description of a computer chip.

Sceptre Services

38. The Appellant traded almost exclusively with Sceptre Services as its supplier from June 2005. On 22 December 2005 HMRC advised the Appellant by letter that some of its trades with Sceptre Services had been traced back to a tax loss exceeding £103,090. On 9 January 2006 Dr Williams emailed Mr Rayer of Sceptre Services advising him that HMRC had identified tax losses in some of the Appellant's trades with Sceptre Services. Dr Williams urged Mr Rayer to ensure that the procedures for Sceptre Services were sufficiently thorough to remove any such losses in the supply chain in the future. The Appellant did not trade with Sceptre Services in January but resumed trading in February and March 2006, completing business with Sceptre Services to the value of £1,498,390.

39. Dr Williams said he got assurances from Mr Rayer that he was sorting out the problems with the suppliers for Sceptre Services. Also according to Dr Williams it took several months before the Appellant could secure new suppliers in place of Sceptre Services. Officer Phillips accepted that the trades in February and March 2006 were not traced back to defaulting traders. After March 2006 the Appellant did not purchase goods from Sceptre Services but on occasions sold goods to it. In April 2006 Dr Williams required Sceptre Services to return a trade application form, part of the due diligence process undertaken by the Appellant. He did this to get a complete set of forms filled in by all the Appellant's customers and suppliers. Dr Williams was

aware from Mr Rayer that Sceptre Services had outstanding disputes with HMRC but was told at the time that Mr Rayer was addressing the issues.

40. Dr Williams stated that he trusted Mr Rayer and believed he was not the sort of person to betray a friend. Dr Williams accepted that the Appellant shared a fax machine with Sceptre Services in a managed office run by Mr Rayer. Dr Williams did not perceive the sharing of a fax machine as a risk. He could not recall seeing faxes containing commercial sensitive information belonging to Sceptre Services, such as the identities of customers and suppliers and the prices agreed. Dr Williams did most of his deals by MSN or by phone, and would not steal the customers and suppliers of Sceptre Services.

41. Dr Williams accepted that Mr Rayer was a signatory on the Appellant's bank mandate for a period of one year to a date in the middle of 2006. Dr Williams stated that he had forgotten that Mr Rayer was still on the mandate. Mr Rayer had been put on the mandate to assist Dr Williams when he was spending the majority of his time on setting up the Appellant's business. Mr Rayer had only exercised the mandate on two occasions.

42. Dr Williams on 3 May 2005 loaned £100,000 to Sceptre Services at the request of Mr Rayer because the company was experiencing cash flow difficulties. The loan was repaid in June 2005, for which Dr Williams received an additional £12,660. At the time Dr Williams did not see anything wrong in lending the money as he believed he was helping out a friend. Dr Williams accepted with hindsight that the loan could be perceived as suspect, particularly as Sceptre Services could be described as a competitor of the Appellant. Officer Phillips accepted that the loan had no relevance to the Appellant's state of knowledge in respect of the four disputed transactions. In his view the circumstances of the loan demonstrated the closeness between Appellant and Sceptre Services and indicative of the Appellant's method of trading.

43. In July and October 2005 the Appellant paid commission of one per cent to the value of £2,447 to Sceptre Services. The commissions related to trades for which the Appellant stood in for Sceptre Services, which was unable to fulfil its commitments. Dr Williams acknowledged that this arrangement enabled the Appellant to have direct contact with the customers and suppliers of Sceptre Services. Dr Williams insisted that he did not abuse the trust placed in him by Mr Rayer of Sceptre Services despite the fact that the Appellant in its own right conducted subsequent transactions with the same suppliers involved in the commission transactions.

The Disputed Transactions

Overview

44. The disputed transactions took place in the 07/06 period when the Appellant made 13 deals, nine deals as a buffer, involving sales to the value of £1,837,019 to other UK traders, and four deals as a broker, despatching goods of a value of £1,214,337 to VAT registered companies in other EU Member States. The four broker deals constituted the disputed transactions.

45. The disputed deals involved supplies of *Astra* semi-conductors on 14 July 2006, 18 July 2006 and 19 July 2006 which the Appellant acquired from the same company, Culmain Limited, and made onward sales to ASAP Trading GMBH in Austria (deals 7, 8 and 9), and to TK Components Limited in Malta (deal 10). The goods were held at freight forwarders, Tech Freight Limited. In deal 7 the goods were shipped to Rotterdam in the Netherlands. In deals 8 and 9 they were shipped to Innsbruck, Austria, and to Germany in deal 10. Evidence from the Austrian authorities showed that ASAP in deals 7, 8 and 9 sold the goods onto TK Components. Evidence from the Maltese Authorities showed that in deal 10 TK Components sold the goods onto Nexdata SRL in Italy

46. Officer Phillips traced from the documentation the chain for each deal. He discovered that each deal was connected with a tax loss occasioned by a defaulting trader. The Appellant did not challenge the composition of the deal chains. The details of the deal chains are set out below including the prices charged and the mark up achieved by each trader.

Deals	**7**	**8**	**9**	**10**
Date	14.07.06	18.07.06	18.07.06	19.07.06
Goods (per Coracle's sales invoice)	Astra Semiconductor ASI124775-BGA	Astra Semiconductor ASI124775-BGA	Astra Semiconductor ADC500A819	Astra Semiconductor ASI124775-BGA
Quantity	3,200	1,600	2,080	4,800
-5	Papoose £89.35	Papoose £89.35	Papoose £126.35	Papoose £89.35
-4	EMS £89.60 +25p	EMS £89.60 +25p	EMS £126.60 +25p	EMS £89.60 +25p
-3	Connect £89.80 +20p	Connect £89.80 +20p	Connect £126.80 +20p	Connect £126.80 +20p
-2	Maximize £90.00 +20p	Maximize £90.00 +20p	Maximize £127.00 +20p	Maximize £90.00 +20p
-1 (Supplier)	Culmain £94.00 +£4.00	Culmain £94.00 +£4.00	Culmain £134.00 +£7.00	Culmain £94.00 +£4.00
Broker	Coracle £96.35 +£2.35	Coracle £96.56 +£2.56	Coracle £137.97 +£3.97	Coracle £96.78 +£2.78
+1 (Customer)	ASAP €141.10	ASAP €141.60	ASAP €202.60	TK
+2	TK	TK	TK	-

47. The deal chain analysis identified E Management Solution (Europe) Limited (EMS) as the UK acquirer of the goods for the Appellant's disputed transactions. EMS was incorporated on 29 January 2002 and registered for VAT on 6 March 2002. A Mr Bhutta acquired the company in February 2006. On 10 August 2006 Mr Bhutta advised HMRC Officers that EMS only dealt in semi-conductors, and had one supplier Papoose based in Slovakia and one customer, Connect Communications Limited (Connect), based in Birmingham UK. Mr Bhutta, however, failed to produce the business records for EMS despite frequent requests from HMRC. On 19 October 2006 Officer Marescaux assumed control of the investigation into EMS. He found that, since Mr Bhutta took over as director, EMS' turnover increased to a figure of £10.5 million. EMS supplied just one VAT return showing output tax of £179.79 due to HMRC. Officer Marescaux decided that EMS had incurred tax losses of £1.9 million for which assessments were raised to recover the unpaid VAT. The assessment of 4 September 2007 in the sum of £459,292.83 included the tax losses occasioned by the four disputed deals, which amounted to £200,536. EMS has not

paid the assessments or appealed against them. EMS also traded with SMS Ireland in high energy drinks after being de-registered for VAT.

48. The records obtained by HMRC from Tech Freight, the freight forwarder, highlighted another participant in the deal chains, Tamlex Trading Limited in Cyprus, which authorised the release of the goods to Papoose in the disputed deals. The e mail from Tamlex releasing the goods to Papoose was timed after Papoose had already released the goods to EMS.

49. HMRC adduced evidence of third party payments in the deals which consisted of payment instructions from Papoose to EMS in the four deals, requiring EMS to pay the majority of purchase monies to Tamlex with a small amount to OPM based in Dubai. EMS in turn issued payment instructions to Connect to make its payments to Tamlex and OPM with a residual amount of about £1,000 to EMS[4].

50. The analysis of the mark-ups for each trader in the deal chains showed that EMS achieved a mark up of 0.28 per cent in deals 7, 8, and 10, and a mark up 0.18 per cent in deal 9; Connect: 0.22 per cent mark up for deals 7, 8, 10 and 0.16 per cent for deal 9; Maximize: 0.22 per cent mark up for deals 7, 8, 10 and 0.16 for deal 9. The mark up for Culmain was 4.4 per cent for deals 7, 8, and 10, and 5.51 per cent for deal 9. The Appellant's mark up was 2.50 per cent (deal 7), 2.72 per cent (deal 8), 2.96 per cent (deal 9) and 2.96 per cent (deal 10). Officer Phillips speculated that the higher mark up for Culmain, the Appellant's supplier, was because Culmain wanted to avoid extended verification of its repayment claims.

51. The purchase and sales orders issued by the Appellant, its supplier and customers and Maximise in the disputed deals contained detailed specifications for the goods. The corresponding documents for Connect, EMS and Papoose did not incorporate the same level of specification for the semi-conductors.

52. The goods for each deal were held at Tech Freight, the freight forwarder. The traders issued instructions to the freight forwarder to release the goods to the next trader in the chain. The individual deals transferring the goods in each chain were concluded on the same day.

53. The bundle did not include a complete record of the payments made between the parties. The Appellant released the goods to ASAP and TK components before it received payment from them. The Appellant did not pay its supplier until it had received payment from its customer.

54. The Appellant did not operate arrangements to retain title on the goods until payment, which meant that it ran a significant commercial risk in passing title to the goods to its customers before receipt of payment.

[4] The bundle at volume 4 121 contains another third party instruction from EMS to Connect, which in the Tribunal's opinion did not relate to this Appeal.

55. Dr Williams considered that he was fortunate not to lose money on the deals but the Appellant's customers honoured their side of the bargain which he thought they would do following his contact with them. Dr Williams acknowledged that it would have made more commercial sense to protect the Appellant's position by making sure that title did not pass before payment was made for the goods. Dr Williams asserted he was entitled to make that decision at the time and he lived by it. Dr Williams indicated that Culmain was prepared to await payment because at the time it was having problems with its bank account with First Curacao International Bank NV (FCIB) in the Netherland Antilles.

56. The Appellant's record of its payments and receipts in respect of each deal was recorded in its bank statements with Lloyds TSB. The details are set out below:

Deal	**Receipt from customer and date**	**Payment out to supplier and date**	**Balance in Appellant's bank account at date of deal**	**Net Margin on each deal**
7: 14 July 2006	£308,313 (18 July)	£353,.440 (18 July)	£245,950	£7,513
8/9: 18 July 2006	£441,446 (19 July)	£504,216 (19 July)	£199,038	£12,326
10: 19 July 2006	£464,538 (21 July)	£530,160 (24 July)	£312,635	£13,338

57. The bundle contained records of payment between Maximize and Connect for the disputed deals in the form of intra account transfers with FCIB which showed that funds were transferred on the same day as the goods were released. The Appellant's supplier, Culmain, held an account with FCIB. The Appellant's bank account was with Lloyds TSB.

58. The Appellant's nine buffer deals in period 07/06, which involved trades in iPods, CPUs and Astra semi-conductors were all traced back to a defaulting trader, and in seven of those deals the Appellant's customer was Sceptre Services.

Deal 7

59. The deal took place on the 14 July 2006 and was for a supply of 3,200 Astra semi-conductors (ASI 124775-BGA).

60. The deal was evidenced by the following documentation produced by the Appellant:

(1) The Appellant's Redhill confirmation of the VAT registration numbers of Culmain and ASAP dated 14 July 2006.

(2) ASAP's purchase order dated 14 July 2006 for 3,200 Astra semi-conductors (ASI 124775-BGA) with the following specification: Enhanced DMA: 64

channels; Timers: 3; I/0: 3.3 V; MIPS: 4,800, Frequency: 600MHz; Full device power: 1.06W. The order also contained additional information: Goods on C-Status//new condition//sealed in original foil//price FOB Tech Freight London Heathrow//goods will be picked up by MITT NL// MITT will provide you with driver/truck details//freight and insurance costs on ASAP Trading GMBH.

(3) Appellant's purchase order dated 14 July 2006 to Culmain 2006 for 3,200 Astra semi-conductors (ASI 124775-BGA), which had an additional specification of an operating voltage of 1.4V. The Appellant's e mail to ASAP dated 14 July 2006 mentioned the operating voltage of 1.4V.

(4) Culmain's sales invoice dated 14 July 2006 to the Appellant was for 3,200 Astra semi-conductors with a reference of AS/124775-BGA instead of ASI 124775-BGA. The sales invoice stated that the goods came with full manufacturer's warranty and were held at Tech Freight Ltd. The sales invoice was accompanied by a supplier's confirmation of due diligence which stated that Culmain had a valid VAT number and was trading under the guidelines laid out by HMCE. Culmain confirmed that it had carried out extensive due diligence of its suppliers and that it had no reason to suspect that there was anything wrong with the supply chain.

(5) Appellant's invoice to ASAP dated 14 July 2006 for 3,200 Astra semi-conductors (ASI 124775-BGA).

(6) Culmain's fax dated 14 July 2006 to Tech Freight releasing 8 boxes of 400 units Astra semi-conductors with a reference of AS/124775-BGA to Dilwyn @ Coracle Ventures Limited.

(7) Appellant's notice dated 14 July 2006 to Tech Freight releasing 3,200 Astra semi-conductors (ASI 124775-BGA) to ASAP Trading giving the freight company as Brinkman with truck details BR-TZ-72.

61. Dr Williams first met Wolfgang Seher of ASAP in 2005 in Cardiff. Their next meeting was at ASAP offices in Kufstein Austria on 26 April 2006 when Mr Eugene Tuninga was also present. In July 2006 Mr Seher invited Dr Williams to attend the football World Cup semi-final match at Munich on 5 July 2006 between Portugal and France. On the following day Dr Williams met Messrs Seher and Tuninga at their offices, where they asked Dr Williams to source semi-conductors for them. Dr Williams contacted the Appellant's usual suppliers, Culmain, Maximize and Leisure Communications, to enquire whether they could provide the semi-conductors. Culmain was the only supplier which was able to meet Dr William's request.

62. Dr Williams concluded deal 7 on his mobile phone whilst he was in Malta discussing a prospective trade with TK Components. Dr Williams explained that he was able to e mail from Malta the necessary documentation to the Appellant's supplier and the freight forwarder to progress the sale. Dr Williams was in flight from the UK to Malta from 06:50 to 10:00. Redhill confirmed the VAT registration numbers of Culmain and ASAP in a fax which was timed at 09:36 on 14 July 2006. Dr Williams pointed out that he had contacted Redhill prior to the 14 July 2006 in anticipation that a deal would be struck.

63. Dr Williams produced a series of e mails between himself and Mr Seher evidencing the discussions on deal 7:

(1) E mail dated 14 July 2006 14.55 from Dr Williams to Mr Seher:

> "Following our telephone conversation earlier this week I have managed to source some semi-conductors that you might be interested in purchasing.
>
> The specification of the semi-conductors is as follows:
>
> Astra-Semiconductors – part number – AS/124775 – BGA
>
> Enhanced DMA (channels) 64 – Timers 3
>
> Operating voltage (V) core 1.4V – 1/0 3.3 – MIPS 4800
>
> Frequency 600 MHZ – Full device power 1.06W
>
> I have eight boxes (400 pcs) per box available today if you are interested. Please call me on my mobile to discuss costs".

(2) E mail dated 14 July 2006 15:39 from Mr Seher to Dr Williams:

> " Perfect I had a request exactly on this mentioned items during the week, I was reading your mail before and passed on these specs as well to the requester from last week. They were in first sight a bit different but it showed up that it was follow up spec on the same basis. So everything is looking fine. Only disadvantage is that I had a request on 9500 units of this and 4800 units of a lower spec of this ASTRA brand …….
>
> I will get a final confirmation in a few minutes. In case the deal is up, what price would u offer them to us? Is the condition new? Which warehouse are they stored in the moment or are they in your office? ……

(3) E mail dated 17 July 2006 08:17 from Mr Seher to Dr Williams:

> "Goods are on the way to our office in Austria now after the Saturday in Netherlands. We expect them to be in around 1200. From this time on I will update you on the payment situation but it looks like the money will hit your account by tomorrow regarding the cut off time in GBP ……."

64. Dr Williams disagreed that the contents of the emails on 14 July 2006 suggested that he was still discussing the deal with ASAP well into the afternoon. Dr Williams asserted that the deal had been struck by the time of the emails, and that they were just a formal record of what was going on. The Appellant's note releasing the goods to ASAP was timed at 15:18 GMT (16:18 BST). Dr Williams acknowledged that he had a busy day on 14 July 2006, describing it as manic and a nightmare.

65. Tech Freight supplied an inspection report for the goods of deal 7 dated 14 July 2006. Dr Williams issued instructions for the report over the phone. The report stated that Tech Freight had carried out a 100 per cent physical inspection which Dr Williams understood to be looking at the boxes, making sure they were not damaged and taking a note of the box numbers. The inspection report also recorded the name of

the manufacturer, the model type and specification, and the country of origin, which was Malta.

Deals 8 & 9

66. These deals took place on 18 July 2006 and were for the supply of 1,600 Astra semi-conductors (ASI 124775-BGA) (deal 8), and 2,080 Astra semi-conductors (ADC500A819) (deal 9).

67. Deals 8 and 9 were evidenced by the following documentation produced by the Appellant:

(1) The Appellant's Redhill confirmation of the VAT registration numbers of Culmain, ASAP and TK Components Ltd dated 19 July 2006.

(2) ASAP's purchase order dated 18 July 2006 which requested the Appellant to supply it with two different devices. The first device involved 1,600 Astra semi-conductors (ASI 124775-BGA) with the following specification Enhanced DMA: 64 channels; Timers: 3; I/0: 3.3 V; MIPS: 4,800, Frequency: 600MHz; Full device power: 1.06W. The second device involved 2,080 Astra semi-conductors ADC500A819 Analogue to Digital Converter with the following specification ADC Single 16 Bit. The order also contained additional information: Goods on C-Status, new condition, sealed in original foil, clean and dust free, 1 year warranty, delivery location Kuehne & Nagel Worgl price exw Techfreight. Goods will be sent with UPS account number 1Z29902Y. Freight and insurance costs to ASAP.

(3) Appellant's purchase order dated 18 July 2006 to Culmain 2006 for 1,600 Astra semi-conductors (ASI 124775-BGA), which had an additional specification of an operating voltage of 1.4V, and 2,080 Astra semi conductors ADC500A819, Analogue to Digital Converter ADC single 16 bit.

(4) Culmain's sales invoice dated 18 July 2006 to the Appellant for 1,600 Astra semi-conductors with a reference of AS/124775-BGA instead of ASI 124775-BGA and for 2,080 Astra semi-conductors ADC500A819 Analogue to Digital Converter ADC single 16 bit in 3 boxes of 600 units and 1 box of 280 units. The sales invoice stated that the goods came with full manufacturer's warranty and were held at Tech Freight Ltd. The sales invoice was accompanied by a supplier's confirmation of due diligence dated 18 July 2006 which stated that Culmain had a valid VAT number and was trading under the guidelines laid out by HMCE. Culmain confirmed that it had carried out extensive due diligence of its suppliers and that it had no reason to suspect that there was anything wrong with the supply chain.

(5) Appellant's invoice to ASAP dated 18 July 2006 for 1,600 Astra semi-conductors (ASI 124775-BGA), and 2,080 Astra semi-conductors ADC500A819.

(6) Culmain's fax dated 18 July 2006 to Tech Freight releasing 4 boxes of 400 units Astra semi-conductors (AS/124775-BGA) and 3 boxes, 600 units and 1 box, 280 units of Astra semi-conductors ADC500A819 to Dilwyn @ Coracle Ventures Limited.

(7) Appellant's notice dated 18 July 2006 to Tech Freight releasing 1,600 Astra semi-conductors (ASI 124775-BGA), and 2,080 Astra semi-conductors (ADC500A819) to ASAP Trading giving the freight company as De Wilde/Van Dongen with truck details BN-DX-05 and driver as Marien van Staalduinen..

68. Tech Freight supplied an inspection report for the goods of deals 8 and 9 dated 18 July 2006 recording that it had carried out a 100 per cent physical inspection. The inspection report also recorded the number of boxes (8), name of the manufacturer, the model types and specification, and the country of origin, which was Malta.

69. Dr Williams' and Mr Seher's discussions in respect of deals 8 and 9 were recorded on e mail exchanges:

(1) E mail dated 18 July 2006 12:54 from Mr Seher to Dr Williams:

> "We have an open order on hand with following quantities and specs:
>
> 13000 pcs of AS/124775-BGA (second version)
>
> DMA 64 – Timers 3 Operating voltage (V) core 1.4V – 1/0 3.3 – MIPS 4812 Frequency 600 MHZ - Power 1.06W
>
> 4900pcs astra adc500a819
>
> Our target prices – 137.70 GBP and 96.35 GBP

(2) E mail dated 18 July 2006 14.48 from Dr Williams to Mr Seher:

> "Ok –thanks for the enquiry.
>
> I've just come off the phone from my supplier and the quantities that you are asking might be a problem at such short notice.
>
> The best I can come up with for today is 1600 pcs of ASI 124775 – BGA @ £96.75 and 2080 pcs of ADC500A819 @ £138.25 –sorry
>
> Please let me know if you are interested (via my mobile ……"

(3) E mail dated 18 July 2006 15:16 from Mr Seher to Dr Williams:

> "I think we have worked out a good compromise in pricing today. Thanks for your understanding – but as you can see yourself the rate for eg from EU to GBP has really changed a lot".

70. Dr Williams was unable to source the second version of the semi-conductor AS/124775-BGA. According to Dr Williams, ASAP accepted the original version of the semi-conductor sold in the 14 July 2006 deal. The difference between the two versions was marginal and related to the speed of operation 4,800 million instructions per second (MIPS) as opposed to 4812.

Deal 10

71. This deal took place on 19 July 2006 and was for the supply of 4,800 Astra semi-conductors (ASI 124775-BGA).

72. The deal was evidenced by the following documentation produced by the Appellant:

(1) The Appellant's Redhill confirmation of the VAT registration numbers of Culmain, ASAP and TK Components Ltd dated 19 July 2006.

(2) TK Components purchase order dated 19 July 2006 which requested the Appellant to supply it with 4,800 Astra semi-conductors (ASI 124775-BGA) with the following specification Enhanced DMA: 64 channels; Timers: 3; I/0: 3.3 V; MIPS: 4,800, Frequency: 600MHz; Full device power: 1.06W. The order also contained additional information: currency:GBP; delivery terms EGL Global Logistic c/o TK Comp. Munich; payment terms 100% same day TT inspection.

(3) Appellant's purchase order dated 19 July 2006 to Culmain for 4,800 Astra semi-conductors (ASI 124775-BGA), which had an additional specification of an operating voltage of 1.4V.

(4) Culmain's sales invoice dated 19 July 2006 to the Appellant for 4,800 Astra semi-conductors with a reference of AS/124775-BGA instead of ASI 124775-BGA. The sales invoice stated that the goods came with full manufacturer's warranty and were held at Tech Freight Ltd. The sales invoice was accompanied by a supplier's confirmation of due diligence dated 19 July 2006 which stated that Culmain had a valid VAT number and was trading under the guidelines laid out by HMCE. Culmain confirmed that it had carried out extensive due diligence of its suppliers and that it had no reason to suspect that there was anything wrong with the supply chain.

(5) Appellant's invoice to TK Components dated 19 July 2006 for 4,800 Astra semi-conductors (ASI 124775-BGA).

(6) Culmain's fax dated 19 July 2006 to Tech Freight releasing 12 boxes of 400 units Astra semi-conductors (AS/124775-BGA) to Dilwyn @ Coracle Ventures Limited.

(7) Appellant's notice dated 19 July 2006 to Tech Freight releasing 4,600 Astra semi-conductors (ASI 124775-BGA) to TK Components requesting the shipment of goods to EGL Eagle Global Logisitics c/o TK Components Lohstrasse 28a 85445 Schwaig/Germany, Thomas Kuhn plus contact numbers.

73. Tech Freight supplied an inspection report for the goods of deal 10 dated 19 July 2006 recording that it had carried out a 100 per cent physical inspection. The inspection report also recorded the number of boxes (12), name of the manufacturer, the model types and specification, and the country of origin which was Malta.

74. On 29 May 2006 TK Components Limited sent a formal introduction by email to the Appellant. Dr Williams, however, pointed out that he had earlier contact with Tom (surname unknown) of TK Components, which led to the email of 29 May 2006.

75. Dr Williams and Ms Sammut of TK Components Ltd concluded the details of deal 10 by e mail:

(1) E mail dated 19 July 2006 13.09 from Dr Williams to Ms Sammut:

> "Following our conversation this morning and our meetings over the weekend I'm very pleased to let you know that I have managed to source some of the semiconductors that you require.

> I have approximately 5,000 pieces of Astra semi-conductor – ASI124775-BGA available to me if you are interested.
>
> Would you please call me on my mobile to discuss prices?"

(2) E mail dated 19 July 2006 16:23 from Ms Sammut to Dr Williams:

> " As well thanks for being reachable all the time and your researches on the BGY spec of ASI. Because the semi-conductors have to reach the factory in dust free condition it is not possible to open them during an inspection – therefore we ask you kindly that we might pay after receiving them with our client.
>
> ……. In order to complete our first deal, the purchase document is attached to you within this mail. Normally we send goods as well to Malta but in this case wants them urgent in south Europe. That is why we choose Munich as delivery location. The worldwide known Forwarder EGL will receive them and couriers them on for us".

76. The TK Components' purchase order was for 4,800 semi-conductors, not the approximate 5,000 mentioned in Dr Williams' e mail dated 19 July 2006. Officer Phillips expressed his surprise that the Appellant had not corrected the anomaly between the purchase orders of the Appellant and its customers regarding the additional specification of 1.4V.

Due Diligence

77. Dr Williams emphasised that the Appellant did not do business with anybody unless he was satisfied that they were genuine business people. Dr Williams considered that the due diligence was first and foremost an information collecting exercise, the purpose of which was to protect his investment in the business.

78. Dr Williams said that the Appellant's due diligence procedures for goods included:

(1) Check the marked price of the goods via discussions with various suppliers and customers.

(2) Ask the freight forwarder if the goods existed.

(3) Obtain copies of inspection reports for the goods.

(4) If possible, check if the goods had been previously supplied.

79. Dr Williams stated that the Appellant's due diligence procedures for suppliers and customers included:

(1) Visit and meet them at their premises.

(2) Complete trading applications forms.

(3) Obtain a formal letter of introduction and copies of company registration and VAT certificates.

(4) Contact trade referees to check trading history

(5) Perform credit checks using credit safe

(6) Check their VAT number with HMRC

(7) Obtain a signed supplier's declaration

80. On or around March 2006 Dr Williams introduced trade application forms for his customers and suppliers as part of the due diligence procedures and devised written terms and conditions for the Appellant's dealings. He intended to draft separate conditions for the Appellant's sales from its purchases but did not get round to it. Dr Williams accepted that the written terms and conditions did not apply to his purchases and sales in the disputed deals. The Appellant's customers and suppliers did not signify in the trade application form their agreement to the terms and conditions. Dr Williams said that he had an understanding with the Appellant's supplier, Culmain, that it would handle problems with defective goods.

81. The Appellant had a process by which it would keep a list of the box numbers of the products (including the semi-conductors) it bought, and check those numbers against those recorded in the inspection reports. This process was introduced to ensure that the Appellant was not dealing in circular trades of the same goods. Dr Williams also mentioned that Mr Sehr of ASAP also put a mark on the boxes of the goods traded by his company. Dr Williams stated that he received confirmation from Mr Sehr that there no such marks on the boxes of the semi-conductors in deals 7, 8 and 9.

Culmain

82. Dr Williams could not recall how he made initial contact with Culmain, which did not advertise on the ICB website. The Appellant's first trade with Culmain was on 15 May 2006, and the customer for the goods was ASAP Trading. Dr Williams denied that ASAP trading put the Appellant in touch with Culmain. According to Dr Williams, Mr Malik from Culmain visited him in Cardiff as part of its due diligence on the Appellant before they did their first trade. On 30 June 2006 Dr Williams conducted his own visit of Culmain's premises where he met its directors.

83. The completed trading application form for Culmain Limited was dated 10 April 2006. Mr Malik, the company secretary, declared that the annual turnover for Culmain was £50 million with a date of incorporation of 6 August 2003. Mr Malik gave a hotmail address for his email. The form in the bundle included copies of the VAT registration certificate, certificate of incorporation, and bank details for Culmain but did not have copies of audited accounts, VAT returns, utilities bills and various other documents said to be with the trading application form.

84. Dr Williams insisted that at the date of the trade application form he was given the missing documents by Culmain but they had been subsequently lost when he moved his office from the upstairs of his house in Cardiff to the garage below. He did not consider the e mail address for Mr Malik unusual even though Culmain was a company with a £50 million annual turnover.

85. Dr Williams asserted that he carried out on-line *Credit Safe* checks on Culmain at the time of entering into the transactions. He supplied one undated hard copy of a

Credit Safe report which did not give a turnover figure for the years ended 31 March 2004 and 2005 and indicated that the company was dormant during those years. The report showed that Culmain's shareholder funds increased from £100 to £92,000, it had a recommended credit limit of £12,000 and a credit rating of 73 per cent. Dr Williams did not consider that it was necessary to have undertaken further financial enquiries about Culmain, despite the apparent inconsistency between a declared turnover of £50m in the trade application form and a credit limit of £12,000. In Dr William's opinion he considered Culmain's credit rating reasonable, and his satisfactory meetings with its directors were sufficient for him to conduct trades with Culmain.

86. Dr Williams said that at the first meeting with Mr Malik they discussed the background to Culmain's business, and filled out various due diligence forms. Dr Williams accepted that he did not ask why Culmain turned over £50 million in such a short period of time because it was not a nice question to ask. The information that he got from the meeting was that Mr Malik was prepared to travel down from Manchester, and that he presented himself in a good light, which in Dr William's view reflected well on the company. Dr Williams formed from the meeting a good opinion of Culmain, which has proved correct as the company was still in existence and trading today. Dr Williams also pointed out that Culmain had been reliable suppliers, with its product arriving on time at the freight forwarders and with no problems over release notes.

87. Dr Williams acknowledged that Culmain would not agree to the Appellant's terms and conditions because, according to Culmain, they did not reflect the correct relationship with a supplier.

88. Dr Williams believed he could do nothing more to check the bona fides of Culmain. He considered that the most important thing was to develop relationships with his suppliers, which enabled better pricing.

ASAP Trading GMBH

89. ASAP Trading provided the Appellant with a trade application form dated 4 April (no year given). At page 2 of the form ASAP omitted to declare its annual turnover. At page 4 the names of two trade referees were supplied. They were both freight forwarders, Mitt Warehouse BV in Rotterdam and Forward Logistics in Ashford. The pack contained information in the German language apparently relating to company and VAT registration.

90. Dr Williams accepted that he did not ask ASAP for copies of its management accounts. Further the trade application form did not include all the documents requested, and that he was unable to translate the documents written in the German language. In Dr William's view, the company was a collection of people, and if the people who represented the company were genuine and straight that was a strong indication of a bona fide company. Dr Williams spent money to meet the personnel of ASAP. He based everything that he did on trusting people and developing relationships.

TK Components Limited

91. TK Components provided the Appellant with a trade application form dated 23 June 2006. On page 2 of the form the address given by TK was incomplete and the section for annual turnover was left blank. At page 4 only one trade reference (Mitt Warehouse BV in Rotterdam) had been supplied and there was no information in respect of the bank account.

92. Dr Williams considered the website of TK Components decent, having eight to ten pages and clearly stating that they were trading in CPUs and iPods. Dr Williams was not concerned about the failure of TK Components to declare its turnover on the form. In his view, turnover was not a critical decision-making point. Dr Williams did not notice that the date of incorporation declared on page 2 was inconsistent with the date given in the documentation evidencing incorporation.

93. Dr Williams denied that he had not exercised proper care in respect of the information given by TK Components. Dr Williams asserted that he had looked at the information. He checked that TK Components was a registered company and held a valid VAT number. Dr Williams had spoken and met its directors and contacted the trade reference given to confirm that TK Components had an account with it.

94. Dr Williams could not perform a credit check on TK Components as it was based in Malta. He considered that the granting of credit to the company was a personal thing which had nothing to do with HMRC. Dr Williams formed his view on the creditworthiness of the company from his personal meetings with the directors of TK Components. He could not remember whether he was given information on the financial position of TK Components by the directors.

The Freight Forwarders

95. Dr Williams visited the freight forwarders, Tech Freight and Forward Logistics, used by the Appellant. He also carried out a Credit Safe check on Tech Freight. The purposes of the visits were to assess their operations and security. He could not recall the insurance arrangements for the freight forwarders.

Insurance

96. On 24 March 2006 the Appellant set up facilities with Iain Brown of Risk Protection for instant cargo insurance if required for the transport of goods. The Appellant, however, did not use the facility because the goods were on risk for a short period of time. The Appellant transferred title to the goods when it released them to its customers. In the disputed transactions the Appellant's customers took on the responsibility for insuring goods.

The Semi-Conductors

97. Semi-conductors are miniature integrated circuits which are used in the manufacture of virtually all electronic products. They are not High Street products sold to individual consumers but are purchased in large quantities by manufacturers.

The size of the individual semi-conductor exhibited in a photograph equated to that of the current one pence piece.

98. On 27 November 2006 Officer Phillips discussed Astra semi-conductors with Dr Williams who stated that he never found out the manufacturer of the semi-conductors and that his research on the products was based on the Appellant's customer's requirements. Dr Williams believed that the semi-conductors were used in smoke detectors or pacemakers, and destined for medical use in Switzerland. Dr Williams expressed his view that the semi-conductors were manufactured in China and repackaged in Malta. Dr Williams promised to provide Officer Phillips with information on the conductors which he did the same afternoon.

99. The information consisted of five photographs which showed the product in various packaging states. The outer package was a cardboard box, inside which the product was sealed in a silver foil wrapper. The box and the silver foil were labelled Astra semi-conductor with a type number and a trace barcode. The label indicated that the product was manufactured in Malta. The packaging gave no contact details for the manufacturer. One photograph showed an individual semi-conductor which had the name of Astra semi-conductor with product number ADC500A819-R1, the subject of deal 9. Mr Coughlin believed that the photograph showed a Texas Instruments TMS320320C6412 Fixed Point Digital Signal Processor Integrated Circuit which was incompatible with the type of the product, an analogue to digital converter, identified by the Astra product number, ADC500A819-R1, affixed to the device in the photograph.

100. The other information supplied comprised a brochure entitled *Intelligent and Powerful* and a document entitled *Guidelines for handling and processing Moisture Sensitive Surface Mount Devices (SMDs)*, which was a generic document. The latter mentioned that the reader of the document should check with Intersil about the suitability of the product for a particular soldering process. Intersil was a manufacturer of semi-conductors of high repute. Mr Coughlin knew of no connection between Intersil and Astra

101. The brochure gave details of the Astra semi conductor and stated that Astra had over 30 years of experience in the design and manufacturing of semi-conductor solutions for the medical market place. The brochure on its back page stated that Astra had sales offices and technical service centres throughout the USA, Europe and Asia. Further Astra had a production, sort and test facility in Malta. The brochure showed a photograph of a factory in Shenzhen China. The brochure gave no contact details for Astra.

102. On the 3 August 2007 Officer Phillips requested further technical information on the semi-conductors. Officer Phillips pointed out that the brochures provided on the 27 November 2006 were generic in nature and did not refer to the specified product. Also the printed information supplied no contact details for Astra. Dr Williams responded by reminding Officer Phillips of his belief that the semi-conductors were re-branded and repackaged versions of another manufacturer's devices. Dr Williams had discovered that semi-conductor, ASI 124775-BGA, was a re-branded version of

Texas Instrument part number TMS320C6412-600, for which he provided the technical specifications. Dr Williams also supplied a copy of a brochure for the AMI semi-conductor, which appeared to be the document plagiarised by persons unknown to produce the Astra semi-conductor brochure provided by Dr Williams to Officer Phillips in November 2006.

103. Dr Williams was unable to recall in evidence his source for the information given to Officer Phillips about the semi-conductors being destined to an end user of medical equipment in Switzerland. Dr Williams believed his statement regarding use of semi-conductors in smoke alarms and pace-makers was derived from him simply picking out those uses from the list given in the plagiarised brochures.

104. According to Dr Williams, he asked Culmain to provide him with information on the semi-conductors, which consisted of the two documents and the five photographs supplied to Officer Phillips on 27 November 2006. Dr Williams gave conflicting accounts of the date when he requested the information from Culmain. During the cross examination of Mr Coughlin, Dr Williams' counsel on instruction informed the Tribunal Dr Williams' request was made in May 2006, which conflicted with Dr William's later evidence that he first heard of the semi-conductors at his meeting with ASAP in July 2006.

105. Dr Williams requested the information from Culmain to validate the existence of the Astra semi-conductors. Dr Williams accepted that Culmain did not provide him with a catalogue or list of products, which in his view was unnecessary as his customer had provided him with a part number. Dr Williams explained that the photographs were of examples of the product not the actual semi-conductors traded in the disputed deals. The photograph of the cardboard box, however, corresponded with a box which Dr Williams saw at the premises of Tech Freight on 17 July 2006. Dr Williams and the freight forwarders were not able to inspect the semi-conductors as they were wrapped in sealed foil to protect them from contamination. Mr Coughlin confirmed that semi-conductor devices had to be handled with care. The devices were very susceptible to damage by electrostatic discharge. Ideally semi-conductors should only be inspected in laboratory conditions.

106. Dr Williams asserted that it was Mr Sehr of ASAP who first raised the subject of the Astra semi-conductors at their meeting on 6 July 2006 following the World Cup semi-final. According to Dr Williams, Mr Sehr was very excited about securing a new customer for a new product. Mr Sehr did not divulge to Dr Williams the detail of the end product for which the semi-conductors were required and the name of the customer. Mr Sehr did not have a great understanding of Astra semi-conductors.

107. When Dr Williams returned to the United Kingdom he asked his friend, Mr Lewis, to find out about the semi-conductors. Mr Lewis confirmed that he received a phone call from Dr Williams regarding the semi-conductors. He originally said in evidence that the phone call took place on the 6 July 2006, however, this date was taken from notes used to refresh his memory during his testimony. The notes had various dates crossed out. Mr Lewis could not explain how he arrived at the date of

the 6 July. Dr Williams equally had no explanation for Mr Lewis' jottings of various dates. Dr Williams denied that he had discussed the case with Mr Lewis.

108. Dr Williams did not investigate Astra semi-conductors online. He considered that Mr Lewis was *good at this sort of stuff*. Dr Williams stated that it was a waste of his time to do the enquiries about the semi-conductors because he did not know what they were. Dr Williams asked Mr Lewis to check the correctness of the specification and the price of the semi-conductors. The purpose of the enquiries was to ensure that the specifications were realistic, not to confirm the existence of the product. Dr Williams considered that, as his customer had requested a supply of the semi-conductors, the product must exist.

109. According to Mr Lewis, Dr Williams told him the brand name for the products, the specification of one of the semi-conductors, and a description of the other semi-conductor. Mr Lewis could not now recall whether Dr Williams gave the specification as ASI or AS/ part number. Following the telephone conversation, Mr Lewis researched the product online. He did not find the Astra semi-conductor but a Texas Instrument product with the same specification for the first semi-conductor. Mr Lewis did not find any information on the internet in relation to the second semi-conductor. He, however, believed from his experience that such a product (analogue to digital converter) would be readily available on the open market. Mr Lewis agreed that it was decidedly odd that he could not find a manufacturer's website for the Astra semi conductors

110. Mr Lewis found on-line a United Kingdom supplier of the first semi-conductor against which he could check the price of that supplier against the indicative price given to him from Dr Williams. According to Mr Lewis, the price for the first conductor in the supplier's website was compatible with the indicative price from Dr Williams. Mr Lewis, however, considered the indicative price of the second semi-conductor to be on the high side but the high figure might be justified if it met the needs of a specific customer.

111. Mr Lewis advised Dr Williams that he did not find a manufacturer's website for the Astra semi-conductors but instead had discovered a link for one of the semi-conductors to the Texas Instruments website. Mr Lewis also advised on his findings on the indicative prices for the conductors. Dr Williams was not concerned about the non-existence of the manufacturer's website. He believed that Mr Lewis' enquiries had confirmed that the semi-conductors were real products which could be sourced from other manufacturers. Dr Williams considered that the semi-conductors were a clean product. He had a customer who had a demand for a product. He saw it as a viable business opportunity. Dr Williams' view was that the semi-conductors existed, their specification was valid, the prices were in the area it should be, and that the semi-conductors had been re-branded.

112. Dr Williams contacted his usual suppliers, Culmain, Maximize and Leisure Communication, to enquire if they could supply the semi-conductors. Culmain was the only one of the Appellant's suppliers which could deliver the product. Dr Williams did not find it surprising that one of his suppliers could provide a product of

which there was no trace on the internet, no website for the manufacturer, and not manufactured by a major global brand such as Intel and Apple.

113.Dr Williams had no idea until Officer Phillip's investigation that Maximize had supplied Culmain with the semi-conductors. Dr Williams was surprised by this revelation, as Maximize had told him categorically that it could not supply the Appellant with the semi-conductors. Dr Williams was also surprised that ASAP was making onward sales of the semi-conductors purchased from the Appellant to TK Components which happened on the day that Dr Williams was meeting with TK Components in Malta.

114. Dr Williams accepted that the packaging for the semi-conductors showed Malta as their place of manufacture. He believed that the products traded in the disputed deals had been re-packaged in Malta. Dr Williams did not give thought to why these products were brought into the United Kingdom. His overriding considerations were that Culmain had access to semi-conductors with a specification which was in demand by prospective customers.

115.Mr Coughlin considered the products described on the Appellant's invoices lacked credibility. There was no website for Astra products. The packaging for the product gave no contact details which meant that the ultimate purchaser of the product had no means of checking whether its technical specification was suitable for its intended use. In Mr Coughlin's view, the use of these devices would be impossible without detailed instructions on how to connect the semi-conductor into a circuit. Mr Coughlin would have expected to have seen a data sheet with the product which explained how the semi-conductor worked and provided the pin-out details. The absence of a data sheet with the semi-conductors in the disputed deals was in Mr Coughlin's view unusual.

116. When Mr Coughlin undertook an internet search for the bare technical details of the semi-conductor ASI 124775-BGA it immediately linked the details to a product on the website of Texas Instruments. Mr Coughlin found no link between Texas Instruments and Astra. Mr Coughlin was of the opinion that the technical details given on the Appellant's invoices were of no value because they related to a product manufactured by a different company from that named in the invoices.

117.Mr Coughlin acknowledged that a wholesaler dealing in semi-conductors would only need the product number, particularly if it was being sourced from a reputable manufacturer of semi-conductors. Also Mr Coughlin conceded that it was plausible for a wholesaler to refer queries about the product to its supplier rather than the manufacturer of the product. Mr Coughlin, however, was adamant that it was critical for parties in the chain to be able to contact the manufacturer to ensure the viability and reliability of the semi-conductor, particularly as it was not possible to inspect the goods.

118. HMRC produced in evidence an email from a Mr Cowles of Texas Instruments dated 7 December 2007 which stated:

"We do not recognize the device name ADC500A819.

We do recognize the product named in your email as TMS320C6412 is a current Texas Instruments DSP IC (Digital Signal Processor Integrated Circuit) with world-wide sales to our direct customers of 141,765 units of which 42,357 units were sold to direct customers in Europe and Israel.

As explained to you on the telephone in addition to large equipment manufacturers to whom we sell chips direct we do sell devices to a number of semi-conductor distributors who in turn sell to smaller end user companies.

On the question of re-labelling, Texas Instruments do not allow re-labelling of our products but we do manufacture custom devices with customer specific symbolisation. Such custom devices would have a different device name to the standard item which they are based upon.

We do not believe that Astra semiconductor or AMI semiconductor are direct customers of Texas Instruments in Europe but AMI semi-conductor is a Texas Instrument competitor that specialises in automotive, medical and aerospace applications.

We are not aware of any counterfeiting activity relating specifically to TMS 320C6412 but in general we are aware that our parts are subject to counterfeiting activities and we are often asked to verify whether parts claiming to be manufactured by us are genuine. We are also aware that unscrupulous dealers may take low specification devices and change the markings to make them appear to be higher specification devices".

119. Mr Coughlin accepted the possibility that the goods described in the invoices might be counterfeit goods manufactured in China. Mr Coughlin, however, pointed out that the counterfeit goods would not be treated seriously unless there was supporting documentation. The plagiarised brochure for the Astra semi-conductors, however, was deficient in that it contained no contact details. In Mr Coughlin's opinion, a trader would be acting rashly if he accepted such documentation because he would not be able to confirm the specification of the product. Mr Coughlin pointed out that licensed products from Texas Instruments still retained the Texas Instruments product number on the component package which enabled the product to be traced back to the manufacturer so that its function could be determined.

120.Mr Coughlin considered the prices paid by the Appellant for the semi-conductors plausible. Mr Coughlin, however, thought that the price for the analogue to digital converter was high which suggested it was a bespoke device. Mr Coughlin opined that a quantity of 2,080 for a bespoke device was unusual.

Consideration

121.The Tribunal is required to determine the following matters in respect of the disputed transactions:

(1) Was there a VAT loss?

(2) If so, was it occasioned by fraud?

(3) If so, were the Appellant's transactions connected with such a fraudulent VAT loss?

(4) If so, did the Appellant know or should it have known of such a connection?

Was there a VAT loss?

122. The Appellant asserted that it had no knowledge of the transactions outside its dealings with its supplier and customers and in those circumstances was unable to agree that there was a VAT loss in respect of the disputed deals. The Appellant, however, did not challenge HMRC's evidence on the tax loss which was to the effect that HMRC suffered a tax loss at the level of EMS. The evidence showed that since February 2006 EMS' turnover had increased to £10.6 million and it had submitted just one VAT return showing output tax in the sum of £179.79. EMS sourced the purported semi-conductors in the disputed deals from Papoose in Slovakia. EMS did not account for VAT on those deals. On 4 September 2007 HMRC assessed EMS for unpaid VAT in the sum of £459,292.83 which included the VAT (£200,536.00) incurred on the disputed deals. EMS has not paid the assessment nor challenged it on Appeal. The Tribunal is satisfied on the evidence that there was a VAT loss in each of the four disputed transactions, which can be attributed to a defaulting trader, EMS.

Were the VAT losses fraudulent?

123. The Appellant did not agree that any tax loss was occasioned by fraud but the Appellant did not challenge HMRC's evidence on the activities of EMS which appeared to be fraudulent. The Tribunal finds in relation to the evidence on EMS:

(1) An excessive high turnover of £10.5 million which was achieved in a short period of time, and bore no relationship with the trader's business infrastructure.

(2) EMS' failure to submit VAT returns and keep adequate business records for the period during which the transactions occurred.

(3) The use of third party payments, which had the effect of depriving EMS of the necessary funds to meet its VAT liabilities.

(4) EMS' director's deliberate obstruction of HMRC's enquiries into its VAT affairs.

(5) Non payment of the assessments issued against it.

(6) EMS trading with SMS Ireland in high energy drinks after being de-registered for VAT.

124.The Tribunal is satisfied on the above findings taken together that the tax losses incurred by EMS were occasioned by fraud.

Were the Appellant's disputed transactions connected with fraudulent VAT losses?

125.The Appellant did not challenge HMRC's evidence on the tracing of the Appellant's disputed transactions back to the fraudulent deals of EMS. The Tribunal is satisfied that the traced chains of invoices, purchase orders and release notes for the Appellant's four disputed transactions as set out in Annex 5 to HMRC's skeleton[5] demonstrated that each of the Appellant's transactions was connected to a fraudulent VAT loss.

126.The Tribunal considers that its findings on the first three issues were not disturbed by the evidence of HMRC on the role of Tamlex Trading Limited in the disputed transactions. The records obtained from Tech Freight, the freight forwarder, highlighted that Tamlex Trading Limited from Cyprus, authorised the release of the goods to Papoose in the disputed deals, the timing of which was recorded as being after Papoose had already released the goods to EMS. The documents also showed that Tamlex was the recipient of the third party payments from Connect.

127. HMRC argued that it did not have to identify precisely who was liable for the fraudulent loss of tax, provided it was clear that there was such a loss in the chain, and the Appellant's deals could be shown to be connected to the fraudulent loss through the documents chain. The Appellant made no submissions on Tamlex's perceived role in the fraud.

128.The Tribunal agrees with HMRC's submissions. The Tribunal disregards the disparity in the timings between the release notes of Tamlex and those of Papoose. In the Tribunal's view there was clear evidence of fraudulent activity on the part of Tamlex, Papoose and EMS in the disputed transactions which cast doubt on the accuracy of the timings on the release notes. Further the evidence of third party payments from Connect to Tamlex showed that both EMS and Papoose were bypassed, which suggested that Tamlex was the head of the fraudulent deal chain. If that is so, the fact that under this reconfiguration of the deal chain EMS may not be the acquirer of the semi-conductors into the United Kingdom was irrelevant for the purpose of establishing a tax loss (see the judgment of Christopher Clarke J in *Red 12 v HMRC* [2009] EWHC 2563 at paras. 83-4). The Tribunal only has to be satisfied that there was a fraudulent tax loss in the disputed deals and that the Appellant's transactions were connected to the loss. In this case the Tribunal finds that the Appellant's four transactions were connected through the document trail to the fraudulent tax losses occasioned by EMS.

Did the Appellant know or should have known?

Introduction

129.The Court of Appeal in *Mobilx* emphasised that the knowledge test was simple and should not be over-refined. The question before the Tribunal is, having regard to objective factors, did the Appellant knew or should have known at the time of

[5] Annex 5 is incorporated as part of the Tribunal's decision.

entering the disputed transactions that they were connected with fraud. The question is essentially one of fact to be determined having regard to objective facts or factors. In this respect HMRC argued that the Tribunal should have regard to the big picture, a phrase coined from the Tribunal decision in *Eyedial Ltd* [2011] UKFTT 47 (TC), which meant all the circumstances surrounding the transactions in question.

130. HMRC's primary case was that the Appellant knew that its four transactions were connected with fraud, but in the alternative the Appellant should have known of the connection. The burden was upon HMRC to prove on the balance of probabilities that the Appellant was not an innocent dupe and that it knew or should have known at the time of entering the disputed transactions that they were connected with the fraudulent evasion of VAT. The evidential burden in relation to the Appellant's knowledge, however, is likely to be a shifting one with HMRC proving a set of facts demonstrating the requisite state of knowledge which demanded an explanation from the Appellant. If the explanation is plausible the evidential burden shifts back to HMRC.

The Facts Found

131.HMRC's final submissions set out a range of factual propositions which in its view demonstrated that the Appellant had the requisite state of knowledge. The Tribunal will consider each of the factual propositions in turn.

132. HMRC alleged that the Appellant had appropriate knowledge of the risks involved in the trade sector dealing with computers and telephones. In those circumstances HMRC contended that it was difficult to comprehend how the Appellant armed with that knowledge would wander into a contrived set of transactions without being aware of their contrived nature.

133.Appropriate knowledge in HMRC's terms meant familiarity with what was said in Notice 726, familiarity with what the Officers told the Appellant on their visits regarding the prevalence of fraud in the sector, and the billions of pounds lost in fraudulent transactions, and a general awareness of widespread fraud in the trade sector.

134. Dr Williams in his evidence accepted that he was aware of Notice 726, and of the risks of fraud in the sector in which the Appellant was trading. Dr Williams did not directly challenge the accounts of the Officers who visited the Appellant from its date of registration but gave a nuanced account of his understanding of the information given to him by HMRC.

135. Dr William's interpretation of the billions of pounds lost by MTIC fraud in the letter of Officer Tromans dated 27 June 2005 was that it was due to *criminal gangs running dodgy goods*. Dr Williams believed that if the Appellant did clean business with trusted customers and suppliers it could avoid the risk of fraudulent transactions. According to Dr Williams, he did not appreciate the full extent of the fraud until he saw the BBC *Panorama* programme in August 2006 after which he decided immediately to cease trading in the sector.

136. HMRC considered Dr William's claim regarding the *Panorama* programme astonishing, particularly in view of the visit from Officer Wride in December 2005 when he was told about the tax losses on the Appellant's earlier deals. HMRC, however, has failed to give an alternative reason for why the Appellant suddenly ceased trading if it was not as a result of the *Panorama* programme.

137.Officer Phillips suggested two possibilities. The first was the notification of HMRC's extended verification of the Appellant's 07/06 claim, but this was not until 29 August 2006 some time after the Appellant's last deal on 8 August 2006. The second was the introduction of the reverse charge mechanism on supplies of mobile phones and computer chips which rendered MTIC fraud impossible in this sector. According to Officer Stone, the reverse charge mechanism did not take effect until 1 June 2007, some considerable time after the Appellant ceased trading.

138. Dr Williams' response to Officer Wride's discovery of tax losses was, in the Tribunal's view, constructive but not effective. He alerted Sceptre Services of his concerns about the discovery of tax losses and requested that Sceptre Services review its due diligence. Dr Williams set about finding new suppliers so that the Appellant could move away from Sceptre Services as its sole supplier. Further Dr Williams revisited the Appellant's due diligence procedures and introduced written terms and conditions.

139. Dr Williams, however, continued to use Sceptre Services as its supplier in the February and March 2006 deals. Although HMRC acknowledged that there was no tax losses associated with those deals, the Tribunal considers that Dr Williams was taking unnecessary risks by continuing with Sceptre Services during the interim period whilst new suppliers were found. Also Dr Williams was prepared to trade with companies which would not agree to the Appellant's new written terms and conditions.

140.The Tribunal is satisfied that at the time of entering the disputed transactions Dr Williams understood that fraud was widespread in the Appellant's trade sector. The Tribunal, however, considers that Dr Williams believed erroneously that he could manage the risks of fraud by dealing with customers and suppliers whom he perceived to be trustworthy based on his personal dealings with them. The Tribunal concludes that when Dr Williams saw the *Panorama* programme he realised that his way of doing business was not suited to the Appellant's trade sector resulting in his decision to wind up the Appellant's business.

141.The Tribunal does not accept Dr William's assertions that the semi-conductors did not fall within the definition of specified goods in Notice 712. The Tribunal agrees with Dr Williams that he was taking a pedantic point which in the Tribunal's view was very much an after thought in an attempt to divert attention away from the difficult cross-examination he was facing.

142.HMRC submitted that the circumstances surrounding the Appellant's trade in semi-conductors was wholly questionable and indicative of the contrived nature of the transactions. HMRC's position was that the goods identified as Astra semi-conductors

were not manufactured by Astra, and that there was no evidence that the manufacturer Astra existed. The evidence showed that Dr Williams knew at the time of entering the transactions that the goods as described by his customer did not exist but nevertheless went ahead with the deals without standing back and questioning whether the non-existence of the manufacturer challenged the propriety of the deal.

143. Dr Williams took a robust stance on the non-existence of the manufacturer. Dr Williams was concerned about whether he could source a product which met the specifications for the product laid down by the Appellant's customer. As far as he was concerned if there was a demand for a product it must exist in some form. It did not matter to Dr Williams whether the product was made by a particular manufacturer. In this case Dr Williams believed that the semi-conductors were re-branded by a company in China.

144.The Tribunal's starting point on the issue of the Astra semi-conductors was the evidence of Mr Coughlin, which in the Tribunal's view was explicit and unambiguous. The Tribunal adopts Mr Coughlin's evidence that the products named in the invoices of the disputed transactions lacked all credibility. No evidence of a manufacturer with the name of Astra could be traced. The specification for the Astra semi-conductor ASI124775-BGA was in fact a specification for a Texas Instrument device. The brochures and the packaging for the Astra semi-conductors had no contact details for the manufacturer, which in Mr Coughlin's view was critical for determining whether the product was fit for use in its ultimate application.

145.The Appellant took a different perspective on the evidence of Mr Coughlin. The Appellant believed that Mr Coughlin supported his proposition that the goods may have been re-branded in China. In this respect Mr Coughlin answered that such an eventuality was plausible. Further Mr Coughlin accepted that it was reasonable for a wholesaler in these products to refer queries about the goods from its customer to its supplier. In the Tribunal's view, it was necessary to view those answers to individual questions in the overall context of Mr Coughlin's evidence. Regardless of the arrangements of individual wholesalers Mr Coughlin was adamant that each trader should know the manufacturer's identity, which was critical for the integrity of the traded goods. Likewise the possibility of counterfeit goods did not, in Mr Coughlin's, view, generate confidence in the product named in the Appellant's invoices. The Tribunal concludes that the clear implication of Mr Coughlin's evidence was that the Appellant should not have proceeded with the purchase and sale of the semi-conductors given the serious concerns posed by the non-identity of the manufacturer.

146. The Tribunal was not impressed with Dr Williams' stance on the existence of the Astra semi-conductors, which did not inspire confidence in his judgment. Dr Williams admitted that he and Mr Sehr of ASAP knew next to nothing about semi-conductors. Dr Williams decided to ask his friend, Mr Lewis, to make enquiries about the product. Mr Lewis, as with Mr Coughlin, was unable to find a website for Astra, but found a match of the specification with a Texas Instrument device. Crucially Mr Lewis conveyed this information to Dr Williams before the prospective deal on 14 July 2006. Dr Williams was not bothered about the non-existence of the Astra semi-conductor. He reasoned that he had a real product because the specification for the

semi-conductor given by Mr Sehr matched that of a device produced by another manufacturer, and he was able to source it from one of his suppliers.

147.HMRC embarked on a detailed analysis of what Dr Williams meant by a real product, suggesting that he must have had concerns about the semi-conductors. In the Tribunal's view such detailed analysis was unnecessary, as the facts spoke for themselves. Dr Williams knew that the Astra semi-conductors did not exist but he still proceeded with the deal, and apparently did not advise his customer of the non-existence of a critical part of its specification, the name of the manufacturer.

148.Equally Dr Williams adopted the same uncritical approach to his supplier, Culmain. Apparently Culmain was able to supply Astra semi-conductors packaged in cardboard boxes and silver foil bearing the Astra name but no contact details. According to Dr Williams, his other principal suppliers, Maximise and Leisure Communications, had never heard of the product. Dr Williams did not find it strange that one of his suppliers could source the Astra brand when he knew that it did not exist and that his other two suppliers had not heard of the brand.

149.Dr Williams stated that he requested Culmain to provide some documentary information about the semi-conductors before he went ahead with the deal. The documents provided were photographs of the analogue to digital semi-conductor and the packaging of the other semi-conductor, a brochure, and generic information about handling sensitive goods (*SMDS* document). The Tribunal is not convinced that Dr Williams obtained this information when he said he did. Dr Williams gave conflicting accounts of when he made the request of Culmain. His counsel on instruction advised the Tribunal that it was in May 2006, which was at odds with his evidence that he approached Culmain for the semi-conductors after being given the specification by Mr Sehr on the 6 July 2006. The request for information was also inconsistent with Dr Williams' explanation for going ahead with the deal, namely, that he could source a product for which there was a demand from his customer. The more likely timing of his request was sometime after HMRC launched its extended verification of the Appellant's 07/06 deals.

150. Even if the Tribunal is wrong about when the Appellant received the documents from Culmain, the Tribunal does not understand how they would have assisted Dr Williams' stated purpose for them of validating the existence of the Astra semi-conductors. The documents and the photographs displayed no contact details for the manufacturer, Astra. The brochure contents indicated that Astra was a substantial manufacturer with sales offices and technical service centres throughout the USA, Europe and Asia and a large plant in China, which was wholly incompatible with Astra not having a website. Finally the *SMDS* document introduced the name of another manufacturer, *Intersil.* The documents and photographs gave no assurance of the existence of the manufacturer, Astra. The documents were self evidently plagiarised which should have raised questions with Dr Williams about the bona fides of the product and the supplier of the documents, Culmain.

151.Dr Williams' stance on the issue of the Astra semi-conductors was that it did not matter if they existed. He could source a product with the specifications required by

his customer. The inspection reports of the freight forwarder and the travel documents demonstrated that a product existed which was despatched to his customers in the European Community. The Tribunal disagrees with Dr Williams' rationale. His confidence that the product met his customer's specification was misplaced. Dr Williams was unable to inspect the semi-conductors to check if they met the specification. He had no idea what was in the cardboard box. What he knew at the time of entering the transactions was that the Astra semi-conductors did not exist, in which case the information provided by his customer and supplier was wrong in a material respect. His belief that the semi-conductors were some form of counterfeit goods indicated that the transaction was tainted with illegality.

152.The Tribunal concludes that the product, Astra semi conductors, had no credibility, which was known by Dr Williams at the time of entering the transactions. The warning signs in respect of Astra semi conductors should have raised questions in Dr Williams' mind about the bona fides of the product and his trading partners and whether he should have proceeded with the deals. Dr Williams chose to ignore the warning signs and went ahead regardless with the disputed deals.

153.Given the ostensible doubts with Astra semi conductors, HMRC contended that Dr Williams' decision to go ahead with the transactions without effective terms and conditions and insurance arrangements was not the action of a business person engaged in arms length commercial dealings.

154.The evidence was that Dr Williams introduced written terms and conditions for the Appellant's trades in April 2006 following Officer Wride's visit in December 2005 informing him of the tax losses in earlier deals. Dr Williams downloaded from the internet model terms and conditions and adapted them to produce the Appellant's written terms and conditions. He did not seek legal advice. Dr Williams pointed out that PL Ventures had managed its business affairs successfully for several years without the need for written terms. The Appellant's trading parties in the disputed deals, however, rejected its terms and conditions, which did not prevent Dr Williams from proceeding with the deals.

155.The terms on which the disputed deals went ahead were that

(1) Culmain transferred title to goods to the Appellant without prior payment on the issue of a release notice to the freight forwarder.

(2) The Appellant in turn likewise transferred title to its customers without payment.

(3) ASAP indicated on its purchase orders that it was responsible for insurance and freight costs. The Tribunal understood the same insurance and freight arrangements applied to the Appellant's sales to TK Components.

(4) The purchase order of TK Components stated that payment in full would be made on inspection of the goods.

(5) The Appellant agreed with its supplier, Culmain, it would not pay for the goods until it received payment from its customers. According to Dr Williams,

Culmain agreed to this arrangement because its bank, FCIB, was at the time experiencing difficulties with bank transfers.

(6) Dr Williams stated that the Appellant had an insurance facility but did not need to call on it for the disputed deals. The duration of the Appellant's ownership of the goods was very short which meant that its risk exposure was virtually non-existent.

156. HMRC contended that the Appellant's arrangements were so divorced from what happened in the real commercial world. In HMRC's view it was fantasy to assume that bona fide commercial traders would release title to high value goods and allow them to be transported overseas without payment and the protection of adequate terms and conditions. Dr Williams' retort was that he was entitled to take commercial risks, and he would suffer the consequences if his customers did not pay. In Dr William's view, his assessment of the risk was correct because his customers met their obligations.

157.The conditions under which the Appellant's deals were transacted departed from the normal situation for MTIC traders, which HMRC conceded during the hearing. Officer Stone in his witness statement at paragraph 44 testified that

> "Neither buffers nor brokers normally offer credit terms and they normally retain ownership of the goods until their customers pay them in full".

158.In this case both Culmain and the Appellant did not retain ownership of the goods until they were paid in full. Also the email exchanges between the Appellant and its customers indicated that the price and payment terms had been a matter of negotiation. TK components included payment on inspection as an express condition of the deal. Also the Appellant passed the insurable risks to its customers who took on responsibility for insurance of the goods once title had been transferred. The Tribunal considers that the circumstances of the Appellant's deals with its customers indicated that they were influenced by negotiations and not bereft of commercial considerations. This finding gives some credence to Dr Williams' evidence that his decision to await payment from his customers was a commercial one and not pre-arranged. The Tribunal's finding is however, subject to the caveat that Dr Williams was only able to do this because his supplier was prepared to do the same in respect of the Appellant, which begged the question *Why?* which did not appear to cross Dr Williams' mind.

159.The Tribunal, however, is less sanguine with the decision taken by Culmain to defer payment from the Appellant. According to Dr Williams, the reason given by Culmain for deferring payment was that it had problems with FCIB. The Tribunal finds this reason convenient and unconvincing. According to Officer Stone in his witness statement at paragraph 57, Culmain's bank, FCIB, was first visited on 5 September 2006 as part of the Dutch authorities' investigation into the bank which was sometime after the date of these deals. Further Culmain's decision to defer payment was not corroborated by documentary evidence and was not an explicit term of the deals with the Appellant.

160. On the evidence there were no valid reasons for why Culmain, which was also a competitor of the Appellant, was prepared to take the risk of releasing goods without payment and no reservation of title unless it knew that the Appellant's customers would meet its obligations. The Tribunal finds that Dr Williams in fear of losing the deal closed his eyes to the commercial irrationality of Culmain's conduct in acquiescing with these arrangements.

161. HMRC submitted that the Appellant's due diligence on its trading partners in the disputed deals was so deficient that no prudent business person would have proceeded with the deals.

162. Dr Williams saw due diligence as an information collecting exercise, the purpose of which was to protect his investment in the business. In this respect Dr Williams misunderstood a critical role of due diligence which was to establish the legitimacy of the Appellant's suppliers, to avoid the Appellant being caught up in a supply chain where VAT would go unpaid.

163. Dr William's approach was determined by his concerns about securing his investment without giving proper regard to the bona fides of his trading partners. In this respect he was easy prey for inscrutable traders which could inveigle him in their fraudulent plans with the promise of payment. In the Tribunal's view, Dr Williams' misunderstanding of due diligence led him to give undue weight to his personal assessment of the trustworthiness of his trading partners, and neglecting the hard information which may have given him a different insight into their legitimacy.

164. The Appellant required Culmain, ASAP and TK Components to complete trade application forms, and provide supporting documentation. In each case documentation was missing or in a foreign language which Dr Williams had not translated. The Tribunal was unconvinced with Dr Williams' explanation for the missing documentation which he said occurred when he moved his office to the downstairs garage.

165. The trade references given by ASAP and TK Components were those of freight forwarders. Culmain also gave a freight forwarder as a reference, as well as one of the Appellant's existing suppliers.

166. Dr Williams in evidence displayed a total disregard of the financial information and the lack of such information in the trade application forms. He did not see the relevance of questioning Culmain about the rapid increase in its turnover or the inconsistency of £50 million turnover with a credit rating of £12,000. Dr Williams had no information on the respective financial positions of ASAP and TK Components which failed to complete the turnover sections in the trade application forms. In the case of TK Components the position was further exacerbated by the inability of the Appellant to secure *Credit Safe* reports because it was registered in Malta. Deal 10 was the first occasion that the Appellant traded with TK Components, which posed questions about the wisdom of Dr William's decision to allow TK Components to pay on inspection.

167.Dr Williams did not explore the financial positions of his trading partners at his meetings with their directors. He considered it was not a nice question to ask about turnover. Dr Williams' description of the meetings and the topics discussed did not appear to enhance the value of the information about the companies. In the Tribunal's view, the meetings were about how well Dr Williams got on with the other directors which had an undue influence on his judgment of whether to do business or not.

168. The Tribunal finds that Dr Williams paid scant regard to information and the lack of it gained from the due diligence conducted on the Appellant's trading partners in the disputed deals. He saw the meetings with the directors of the trading partners as an opportunity to assess their personal chemistry and to strike deals and in so doing neglected the chance to confirm the bona fides of the companies involved. Dr Williams' disregard of the financial status of the partners in the deals was incomprehensible in commercial terms. Equally the Appellant's decision to proceed with the disputed deals on such scant information of its partners was a high risk strategy not justified on sound commercial principles.

169.Dr Williams could not recall how he first made contact with Culmain. He stated that he did not find Culmain on a website. The Appellant's first deal with Culmain was on 15 May 2006 which co-incidentally involved ASAP as the customer. Dr Williams denied that ASAP introduced Culmain to the Appellant. The Tribunal finds Dr Williams' memory failure convenient.

170.There were other features of the disputed transactions which merited the attention of the Tribunal. The email exchanges between the Appellant and its customers indicated an intention on the part of the parties to enter into genuine negotiations on price and quantities required, which were not features normally associated with transactions vitiated by fraud. Also the email exchanges undermined HMRC's assertion that the Appellant was able to supply the exact quantities of the goods required by the customers.

171.The value of the email exchanges for the Appellant's case was somewhat undermined by their late disclosure with Officer Phillips having had no opportunity to consider them prior to the hearing. Also Dr Williams in his cross-examination compromised the evidential strength of the email exchanges with ASAP on 14 July 2006 when he said that the deal had already been struck by the time of the emails which were simply a formal record of their discussions. Dr Williams by his admission robbed the emails of their real time quality, and in so doing eroded the genuineness of the reported negotiations.

172.The Appellant did not use the services of an off-shore bank in its dealings but instead used a UK bank, Lloyds TSB. This was uncharacteristic of MTIC traders according to paragraph 55 of Officer Stone's witness statement. On the other hand, Dr Williams believed that the apparent place of manufacture for the Astra semi connectors was Malta. Dr Williams gave no thought to the reasons for importing goods allegedly manufactured in Malta into the United Kingdom, only for them to be exported out.

173.Turning to the circumstances of the wider fraudulent scheme with which the disputed transactions were connected. HMRC contended that the four deals had striking patterns in respect of the composition of the chains, the identities of the traders involved, and mark ups. The striking patterns were enhanced when the four disputed deals were seen in the context of the Appellant's buffer deals in the same VAT period. The striking patterns demonstrated the contrived nature of the disputed deals which, according to HMRC, made it difficult for the Appellant to deny that it did not know about the fraud.

174.The evidential purpose of setting the disputed transactions in the context of the overall fraudulent scheme is to assist the Tribunal's understanding of the true nature of the Appellant's deals. The evidence of the overall scheme does not alter the character of the individual transaction but to discern it. This is made clear in the judgment of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563:

> "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."

175. In one sense HMRC's assertion about the contrived nature of the deal chains involving the disputed deals was stating the obvious. The Tribunal has already decided on the existence of a fraudulent scheme to which the Appellant's transactions were connected. The contrived nature of the deal chains was a necessary part of that finding. The question, therefore, posed by the examination of the attendant circumstances is how does it inform the Tribunal's understanding of the Appellant's state of knowledge at the time it entered the disputed transactions.

176. The Tribunal finds in relation to the deal chains that

(1) Each chain involved seven participants and characterised by the same parties in the same sequence except that deal 10 involved a different customer in TK components. The enquiries of overseas authorities revealed that the customer in deals 7, 8 and 9, ASAP, made onward sales to TK components, which suggested a degree of collusion between the Appellant's customers.

(2) In each deal Maximize was the supplier of the Astra semi-conductors to Culmain. Maximize had informed the Appellant that it was unable to source the semi-conductors.

(3) The transactions involving the transfer of goods to the Appellant occurred on the same day.

(4) The buffers, Papoose, EMS, Connect and Maximise, charged in each deal chain the same unit mark up of 20 pence or 25 pence in the case of Papoose. The Appellant's supplier, Culmain's unit mark up was expressed in whole pound (£) sums of £4 for deals 7, 8 and 10, and £7 for deal 9.

(5) Culmain achieved a higher mark up on the deals than the Appellant. This was not characteristic of normal MTIC trades where the broker usually charges the highest mark up to reflect its greater risk exposure to HMRC's investigation of its repayment claims. HMRC accepted that this was an odd and unexplained feature of the case.

(6) The Appellant's unit mark up in monetary terms was different for each deal, and not expressed as whole sums rounded to the nearest pound (£).

(7) The consequence of the Appellant's low mark up relative to that achieved by its supplier, Culmain, was that the gross profit made by the Appellant on the four deals was modest, totalling about £33,000. This figure did not meet HMRC's description of the Appellant making relative substantial profit in the transactions[6]. The deals from the Appellant's perspective were not too good to be true.

(8) The limited evidence on money flows compromised HMRC's depiction of back to back transactions which are normally characterised by a flow of goods going in one direction and the flow of money going in the other direction. The records of payment between Maximize and Connect for the disputed deals showed that funds were transferred on the same day as the goods were released,

[6] See HMRC's closing submissions Transcript 9 June 2011 page 26 lines 3;4.

prior to the dates of the money payments from the Appellant to its supplier, Culmain, and from the Appellant's customers to the Appellant.

(9) There was a marked contrast in the amount of detail on the goods specification in the invoices of Papoose, EMS and Connect from that on the invoices of the other traders, including the Appellant. The invoices for the first three traders simply gave the name of the semi-conductor, and its product number, whereas the invoices for the other traders incorporated the specification for the semi-conductors.

177. The Tribunal concludes from the facts found on the wider fraudulent scheme that the picture painted by HMRC of striking similarities, contrivance and pre-ordination was too simplistic. The Tribunal's analysis revealed that the features of contrivance, collusion and pre-ordination were predominant in the transactions outside the Appellant's deals. Aspects of the Appellant's transactions with its customers had the semblance of commercial arms length dealings and appeared to be influenced by the Appellant's negotiations with the parties. The Appellant's mark up was not formulaic and resulted in a modest gross profit.

178. The Tribunal did not hear detailed evidence regarding the buffer deals conducted by the Appellant in 07/06 period. Officer Phillips supplied an overview of the buffer deals in his witness statement supported by the deal documentation. Officer Phillips' analysis showed that the buffer deal chains were of similar length and involved many of the parties to the disputed deals. All the buffer deals were traced back to a tax loss and a defaulting trader. The Tribunal was not persuaded by HMRC's reliance on the buffer deals. The analysis of those deals was superficial and the purported striking similarities did not go beyond the involvement of some of the same parties identified in the disputed deals which could equally be explained by the Appellant having settled trading relationships.

179. The other key feature of the buffer transactions was the participation of Sceptre Services which acted as the broker in seven of the nine buffer deals, and in six of those as the direct customer of the Appellant. HMRC argued that under the *big picture* the Appellant's dealings with Sceptre Services and its early trades were relevant to the Tribunal's determination of the Appellant's state of knowledge in the disputed transactions, even though Sceptre Services was not a party in those transactions. HMRC argued that the evidence regarding Sceptre Services and the Appellant's early trade was part of the penumbra of the *big picture*. HMRC's purpose for introducing this evidence was to demonstrate the non-commercial nature of Appellant's whole operations in the market sector.

180. The Tribunal considers that HMRC's submission strained the limits of the *big picture* approach in respect of the scope of the evidence relevant to the question of knowledge, and compromised the principle of VAT law that each transaction should be viewed on its merits. Christopher Clarke J in *Red12* indicated that the true nature of individual transactions may be discerned from the pattern of transactions of which the individual transaction in question formed part. Judge Bishopp in *Eyedial* described the *big picture* as meaning all of the circumstances surrounding the transactions in

question[7]. The Appellant's dealings with Sceptre Services did not form part of the disputed deal chains. The circumstances of these dealings were complicated by the personal relationship between Dr Williams and Mr Rayer, the owner of Sceptre Services, which in the Tribunal's view limited the value of any conclusions drawn from them for the Appellant's state of knowledge in the disputed transactions. Thus the Tribunal decides that the evidence relating to Sceptre Services was too remote, and, if not, the conclusions to be drawn were restricted to the particular circumstances of the Appellant's relationship with Sceptre Services. In similar vein the Tribunal places no weight on the Appellant's early dealings in the market.

181. The Appellant placed some weight on Officer Wride's description of Dr Williams as a reasonable and proper business person with the implication that Dr Williams did everything properly. The Tribunal is required to form its view on the Appellant's state of knowledge, having regard to the objective factors relating to the disputed transactions. In this respect Officer Wride's perception was not an objective factor, and in any event her dealings with the Appellant pre-dated the transactions in question.

182. Finally HMRC submitted that the Appellant's instant success in the trade sector with minimal market research was not what a reasonable business person would expect to happen when he starts in a new field. In response Dr Williams stated that he gave some thought to the Appellant's rapid and substantial increase in turnover and found it surprising but he was doing his very best to make the business a success. In Dr Williams' view, the venture represented a high risk for him for a modest return. According to Dr Williams his life savings were at risk with the large money movements associated with the Appellant's business.

183. In the Tribunal's view, the circumstances surrounding the Appellant's entry in the trade sector did not shed light on the Appellant's state of knowledge in relation to the disputed transactions. The events surrounding the Appellant's entry were strongly connected with its links with Sceptre Services, which the Tribunal has decided to disregard. Also Dr Williams's entry into the wholesale marketing of CPUs was conceivably a rational move having regard to his prior work and trade experience in the IT sector.

Evaluation of the Facts Found

184. The Tribunal now stands back and evaluates the facts found against the question: Did the Appellant knew or should have known at the time of entering the disputed transactions that they were connected with fraud?

185. The Tribunal summarises the principal facts found starting with those relating specifically to the circumstances of the disputed transactions:

(1) Dr Williams understood at the time of entering the disputed transactions that fraud was widespread in the Appellant's trade sector. Dr Williams held an

[7] Paragraph 17 *Eyedial Ltd* [2011] UKFTT 47 (TC)

erroneous belief that he could manage the risks of fraud by dealing with customers and suppliers whom he perceived to be trustworthy based on his personal dealings with them. When Dr Williams saw the *Panorama* programme he realised that his way of doing business was not suited to the Appellant's trade sector resulting in his decision to wind up the Appellant's business.

(2) Dr Williams knew at the time of entering the transactions that the Astra semi-conductors did not exist. He had no idea what was in the cardboard box. The goods described as Astra semi-conductors in the documentation had no credibility. Dr Williams also knew that the information on the semi-conductors provided by his customer and supplier was wrong in a material respect in respect of the manufacturer's identity. Dr Williams' belief that the semi-conductors were some form of counterfeit goods indicated that the transaction was tainted with illegality. The warning signs in respect of Astra semi-conductors should have raised questions in Dr Williams' mind about the bona fides of the product and his trading partners and whether he should have proceeded with the deals. Dr Williams chose to ignore the warning signs and went ahead regardless with the disputed deals.

(3) The circumstances of the Appellant's deals with its customers indicated that they were influenced by negotiations and not bereft of commercial considerations. This finding gives some credence to Dr William's evidence that his decision to await payment from his customers was a commercial one and not pre-arranged. The Tribunal's finding is, however, subject to the caveat that Dr Williams was only able to do this because his supplier was prepared to do the same in respect of the Appellant, which begged the question *Why?* which did not appear to cross Dr Williams' mind.

(4) There were no valid reasons for why Culmain, which was also a competitor of the Appellant, was prepared to take the risk of releasing goods without payment and no reservation of title to the Appellant unless it knew that the Appellant's customers would meet its obligations. The Tribunal finds that Dr Williams in fear of losing the deal closed his eyes to the commercial irrationality of Culmain's conduct in acquiescing with these arrangements.

(5) Dr Williams misunderstood the critical role of due diligence which was to establish the legitimacy of the Appellant's suppliers to avoid the Appellant being caught up in a supply chain where VAT would go unpaid. His misunderstanding of due diligence led him to give undue weight to his personal assessment of the trustworthiness of his trading partners, and neglected the hard information which would have given him a different insight into their legitimacy.

(6) Dr Williams paid scant regard to the information and the lack of it gained from the due diligence conducted on the Appellant's trading partners in the disputed deals. He saw the meetings with the directors of the trading partners as an opportunity to assess their personal chemistry and to strike deals and in so doing ignored the chance to confirm the bona fides of the companies involved. Dr William's disregard of the financial status of the partners in the deals was incomprehensible in commercial terms. Equally the Appellant's decision to

proceed with the disputed deals on such scant information about its partners was a high risk strategy not justified on sound commercial principles

(7) The email exchanges between the Appellant and its customers indicated an intention on the part of the parties to enter into genuine negotiations on price and quantities required, which were not features normally associated with transactions vitiated by fraud. The value of the email exchanges for the Appellant's case was somewhat undermined by their late disclosure with Officer Phillips and by Dr Williams' testimony which robbed the emails with ASAP of their real time quality, and in so doing eroded the genuineness of the reported negotiations.

(8) The Appellant did not use the services of an off-shore bank in its dealings but instead used a UK bank, Lloyds TSB.

(9) Dr Williams believed that the apparent place of manufacture for the Astra semi-connectors was Malta. Dr Williams gave no thought to the reasons for importing goods allegedly manufactured in Malta into the United Kingdom, only for them to be exported out.

186. The Tribunal's analysis of the Appellant's transactions within the context of the fraudulent deal chains revealed that the features of contrivance, collusion and pre-ordination were predominant in the transactions outside the Appellant's deals. Aspects of the Appellant's transactions with its customers had the semblance of commercial arms length dealings and appeared to be influenced by the Appellant's negotiations with the parties. The Appellant's mark up was not formulaic and resulted in a modest gross profit.

187.The purposes of the Tribunal standing back are to attach weight to the findings of fact and build an overall picture upon which the Tribunal can determine the Appellant's state of knowledge at the time of entering the disputed transactions. The backdrop is that the disputed transactions were connected with the fraudulent evasion of VAT, and that Dr Williams was aware of the widespread risk of fraud in the Appellant's trade sector. The dominant colours of the overall picture were Dr Williams' knowledge that the product, Astra semi-conductors, did not exist, and his uncritical stance in respect of his trading partners. Those dominant colours, had shades of commercial arms length dealings on the part of the Appellant in respect of its negotiations with its customers, the variable mark ups on the deals and the modest gross profit achieved. Given that picture the Tribunal is satisfied that this was not a case of the Appellant knowing that its transactions were connected with fraudulent tax losses.

188.The issue in this case was whether at the time of entering the transactions the Appellant should have known of their fraudulent connection. The ECJ in *Kittel* on the *should have known test*, said at paragraph 51:

> "In the light of the foregoing, it is apparent that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT …."

189. The Court of Appeal in *Mobilx* provided the following analysis of *Kittel* :

> " 51 If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in Kittel. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises".

190. Then at paragraph 59 the Court said:

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

191. At paragraphs 75, and 85 the Court of Appeal provided further elaboration:

> "75 The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT".
>
> " 85 …..A trader who chooses to ignore circumstances which can only reasonably be explained by virtue of the connection between his transactions and fraudulent evasion of VAT, participates in that fraud and, by his own choice, deprives himself of the right to deduct input tax".

192. Given that the Appellant's transactions were connected with fraud the question the Tribunal must determine is whether the Appellant should have known that the only reasonable explanation for its transactions were that they were connected with fraud. The Appellant cannot escape the consequences by choosing to ignore circumstances which can only be reasonably explained by virtue of the connection between its transactions and the fraud.

193. The Tribunal returns to the facts found. The nature of the product was pivotal to the case and the reason for the transactions taking place. The Tribunal's findings on the product symbolised the Appellant's overall approach to the disputed transactions. Dr Williams knew that the product, Astra semi-conductors, did not exist but he carried on regardless with the deals. Dr Williams did not stand back and challenge his customer about the wrong information given or ask his supplier on how it could source non-existent products. He just assumed that the semi-conductors were counterfeit goods, which in itself questioned the bona fides of the deal.

194.Dr Williams believed that he could proceed with the transactions because his trading partners were trustworthy. Dr Williams, however, assessed their trustworthiness from judgments made on the personal qualities of their directors. In so doing Dr Williams chose to ignore hard information or the absence of information on the companies' finances and trading operations, and avoided asking the directors awkward questions. If he had done so, he would have come to a different conclusion about whether to do business with his trading partners.

195.Dr Williams' uncritical stance was the recurrent theme underpinning the facts found. He did not question the irrational decision taken by the Appellant's supplier to release the goods without payment and no reservation of title. He did not consider it strange that goods made in Malta should be brought to United Kingdom for despatch to Member countries. In short, Dr Williams was so intent on doing the deals that he closed his eyes to the surrounding circumstances which were shouting fraudulent deals.

196.Dr Williams' response to HMRC's case was that he was an honest trader and would not get involved in fraudulent trades. The Tribunal accepts that Dr Williams held sincere intentions which were demonstrated by those aspects of the Appellant's transactions that had Dr Williams' handprint of commercial arms length trading, and reflected in the Tribunal's decision that the Appellant did not know of the connection with the fraudulent trades. The issue for the Tribunal is whether at the time of entering the disputed transactions Dr Williams should have known that the only reasonable explanation for them was that they were connected with fraud. The Tribunal's findings revealed that the connection of the disputed transactions with fraud was obvious from the moment when Dr Williams discovered the non-existence of Astra semi-conductors. Following his discovery Dr Williams chose to carry on with the transactions regardless and at the same time closed his eyes to the shortcomings of his trading partners in the mistaken belief that he could trust them. Dr Williams was fully aware of the widespread risk of fraud in the Appellant's trade sector, and had he opened his eyes to the circumstances of the deals and his trading partners he would have realised that the only reasonable explanation for the transactions was their connection with fraud. The Tribunal decides on the facts found that the only reasonable explanation for the transactions was their connection with fraud, and that Dr Williams should have known this.

Decision

197. The Tribunal decides that

(1) There was a VAT loss in each of the four disputed transactions, which can be attributed to a defaulting trader, EMS.

(2) The tax losses incurred by EMS were occasioned by fraud.

(3) The Appellant's four transactions were connected to the fraudulent tax losses occasioned by EMS.

(4) The Appellant should have known at the time of entering the disputed transactions that the only reasonable explanation for them was their connection with fraud.

198. The Tribunal, therefore, dismisses the Appeal and upholds HMRC's decisions denying the Appellant's repayment claim of £206,696.00 in respect of four transactions in VAT period 07/06.and the assessment in the sum of £1,501.57.

199. The Tribunal reserves its position on costs. If a party wishes to apply for costs it must submit an application to the Tribunal within 28 days of release of this decision with a copy to the other party. If an application is submitted either party may apply for a determination if costs cannot be agreed.

200. 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.

TRIBUNAL JUDGE
RELEASE DATE: 27 September 2011