TC01752

Appeal number: LON/2007/0663
and LON/2007/0664

Value Added Tax - MTIC appeal involving purchases of razor blades by the Appellants in April and May 2006 - whether the Appellants should have known that their purchases were connected to the fraudulent evasion of VAT – appeals dismissed

FIRST-TIER TRIBUNAL

TAX

DAVIS & DANN LIMITED **Appellants**
PRECIS (1080) LIMITED

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
SHAHWAR SADEQUE

Sitting in public at 45 Bedford Square, London WC1 on 27, 29 and 30 June and 1 and 8 July 2011

David Scorey and Edward Brown, Counsel, instructed by BTG Tax, for the Appellant

Jeremy Benson QC and David Bedenham, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against decisions by the Respondents ("HMRC") denying Davis & Dann Limited ("**Davis & Dann**") and Precis (1080) Limited ("**Precis**") (together, "the Appellants") the right to deduct input tax in a total amount of £4,350,641.09. Of this total amount, £2,138,108.86 of input tax has been denied to Davis & Dann and £2,212,532. 23 has been denied to Precis.

2. The disputed transactions all concerned the purchase of Gillette Mach 3 ("M3") Power razor blades. Both the Appellants are subsidiaries of a company called Kanta Enterprises Limited ("Kanta" or "the Kanta group").

3. Davis & Dann entered into 24 separate deals (contained in 13 invoices) in its VAT period 04/06. Davis & Dann purchased the razor blades from Bristol Cash & Carry Limited ("**Bristol**") and on sold them to Complementos de Exportation Multifunctionales SA ("**CEMSA**"), a Spanish wholesaler. In respect of each transaction, the fraudulent evader Leeming Distribution Limited ("**Leeming**") was at the top of the transaction chain. HMRC rejected Davis & Dann's claim for an input tax deduction in respect of these transactions by a decision letter dated 26 March 2007.

4. Precis entered into 12 separate deals (contained in seven invoices) in its VAT periods 04/06 and 5/06. Precis also purchased its razor blades from Bristol and on-sold them to CEMSA. Again, the fraudulent evader at the top of each chain was Leeming. HMRC rejected Precis's claim for an input tax deduction in respect of these transactions by a decision letter dated 26 March 2007.

5. The issue in these appeals is whether the Appellants should have known that its disputed transactions were connected with the fraudulent evasion of VAT.

MTIC Transactions – Background

6. HMRC contend that all the transactions entered into by the Appellants, on which they based their claims to deduct input tax, are connected to what is described as "Missing Trader Intra-Community" ("MTIC") fraud. The "classic way" in which the fraud works was described by Christopher Clarke J in *Red 12 Trading Ltd v HMRC* [2009] EWCH 2563 as follows (at paragraph 2):

> "2….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 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.
>
> ….
>
> 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".

7. For simplicity, but without thereby prejudging the issue, we shall adopt the same terminology of "defaulter (s)" or "defaulting trader"(sometimes also known as "missing traders"), "buffers" and "brokers". References to HMRC in this decision also include its predecessor, HM Customs and Excise.

Evidence

8. We were provided with four lever arch files containing witness statements and exhibits. We were provided with a further lever arch file containing certain invoices. In addition, we were provided with a bundle containing pleadings and selected correspondence between the parties.

(1) Witness statements from the following witnesses were admitted as evidence. These witnesses did not give oral evidence and their witness statements were accepted and were not challenged by the Appellants. The witnesses were:

(2) Mr Roderick Stone – a senior HMRC officer; and

(3) Ms Erika Nketiah – an HMRC officer responsible for carrying out extended verification on Precis.

9. The following witnesses were called by HMRC. They produced witness statements which were admitted to evidence and gave oral evidence. The witnesses were as follows:

(1) Ms Susan Okolo – an HMRC officer responsible for Davis & Dann; and

(2) Ms Victoria Jones – an executive employed by Procter & Gamble. The Proctor & Gamble group own The Gillette Company and its subsidiaries, which manufactured the razor blades involved in this appeal. Ms Jones produced two witness statements: one statement in respect of Davis & Dann and the other in respect of Precis.

(3) Mr Gordon Young – an officer of the Serious Organised Crime Agency who was an officer of HMRC at the times material to this appeal.

10. The following witnesses were called by the Appellants. They produced witness statements which were admitted to evidence and gave oral evidence. The witnesses were as follows:

(1) Mr Rashmi Chatwani – a director of both Appellants;

(2) Mr Satish Chatwani – a director of both Appellants; and

(3) Mr Rakesh Tailor – a manager of both Appellants.

Procedural history

11. The procedural history of these appeals is worth some explanation.

12. Initially, HMRC alleged that the Appellants had actual knowledge that their disputed transactions, which form the subject matter of these appeals ("the disputed transactions" or "disputed deals"), were connected to the fraudulent evasion of VAT. In the alternative, HMRC also alleged that he Appellants should have known that their transactions were so connected. In the event, as we shall see, HMRC withdrew the allegation of actual knowledge with the result that the only substantive issue in dispute was whether the Appellants should have known that their transactions were connected with VAT fraud.

13. There were a number of interlocutory hearings which preceded the substantive hearing of these appeals. In particular, there was a hearing on 20 April 2009 before Judge Clark. At this stage HMRC were still alleging that the Appellants both knew or should have known that their transactions were connected with fraud. The Appellants complained that HMRC's case as to the nature of and the participants in the fraud was unclear. Furthermore the Appellants argued that HMRC had failed to make proper disclosure regarding the fraud then alleged. At the hearing on 20 April 2009 the Appellants applied for specific disclosure (including disclosure in respect of all companies in the supply chains), further and better particulars in respect of the case pleaded by HMRC and redactions in HMRC's witness statements in respect of unpleaded allegations or amendments to the Statement of Case.

14. At the hearing, counsel for HMRC confirmed that:

(1) the allegation of fraud in the supply chains related to Leeming only;

(2) it was this fraud which was the subject matter of the "overall scheme to defraud" of which it was said the Appellants were aware or ought to have been aware; and

(3) therefore, disclosure in respect of the intermediate traders was not necessary or relevant.

15. Judge Clark, therefore, directed that HMRC make disclosure in respect of Leeming only. Paragraphs 3 and 4 of the directions of 8 February 2010 provided as follows:

> "3. In respect of fraudulent evasion, the Respondents' case is to be construed as limited to the allegation that Leeming Distribution Limited was the fraudulent evader of VAT.
>
> 4. Any evidence of the Respondents' witnesses alleging that other parties were fraudulent evaders shall be deleted from the evidence served on the Tribunal."

16. In addition, the Appellants were directed to notify the Tribunal whether they accepted that the default occasioning a loss was fraudulent and whether they accepted that the Appellants' transactions were connected with the default. On 18 March 2010 the Appellants confirmed that none of these issues was in dispute, save that they put HMRC to proof that the tax loss continued.

17. The Appellants took the view that HMRC had subsequently failed to redact their witness statements in compliance with the direction of Judge Clark. The Appellants objected to HMRC's approach and the matter came before Judge Brannan on 3 May 2011.

18. At this hearing, HMRC withdrew the previously pleaded allegations that the Appellants were complicit in and/or had actual knowledge of the fraudulent evasion of VAT and Judge Brannan, inter alia, required certain amendments to the Statement of Case to conform to the directions of Judge Clark.

The transactions

19. The disputed transactions and (associated deal chains) are set out in Appendix 1 to this decision. This information was derived from the witness evidence admitted on behalf of HMRC and was not in dispute between the parties. As noted above, Davis & Dann entered into 24 separate deals (contained in 13 invoices) and Precis entered into 12 separate deals (contained in seven invoices). For convenience, the transactions recorded on the same invoice have been treated for the purpose of Appendix 1 as the same transaction.

20. It will be seen that Leeming was the defaulting trader in every deal chain. In every transaction Davis & Dann or, as the case may be, Precis purchased razor blades from Bristol and sold them to CEMSA (a Spanish company). All the transactions related to a particular type of Gillette razor blade, viz the M3 Power razor blade. All the purchases from Bristol and sales to CEMSA were carried out on a back-to-back basis.

The issues in dispute

21. The Appellants accepted that there had been a fraudulent evasion of VAT by Leeming and that the Appellants' appealed transactions summarised in Appendix 1 were connected with that fraudulent evasion. During the course of the hearing before us, the Appellants accepted that the tax loss resulting from the fraudulent evasion was continuing.

22. The only issue in contention between the parties, therefore, was whether the Appellants should have known that its transactions were connected with the

fraudulent evasion of VAT. HMRC, following its concession at the hearing on 3 May 2011, did not argue that the Appellants knew that their transactions were so connected.

The law

23. Essentially, the basic legal principles applicable to these appeals were not in dispute. There was, however, disagreement concerning the correct application of these principles in the circumstances of these appeals and we deal with this later in this decision.

24. There is now extensive case law on the subject both before the European Court of Justice and our domestic courts. The position was recently summarised by Lewison J in the recent decision of the Upper Tribunal in *Brayfal Ltd v HMRC* [2011] UKUT 99 (TCC) as follows (at paragraph 4):

> "[T]he law has been considered by the courts on a number of occasions. It finds its latest authoritative pronouncement in the decision of the Court of Appeal in Mobilx Ltd v HMRC [2010] EWCA Civ 517. This decision was handed down on 12 May 2010, a couple of months after the revised decision of the FTT. That case examined the ramifications of the decision of the ECJ in Axel Kittel v Belgium; Belgium v Recolta Recycling Joined Cases C-439/04 and C-440/04 [2006] ECR 1-6161 ("Kittel"). What the Court of Appeal decided was:
>
> A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and fails to meet the objective criteria which determine the scope of the right to deduct. (§ 43)
>
> If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. (§ 52)
>
> The principle does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion. (§ 60)
>
> The test is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. (§ 59)

> If HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion. (§ 81)
>
> In answering the factual question, Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focusing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was. (§ 82)
>
> I should also record that it was common ground that these principles should be applied in the light of the circumstances prevailing at the date of the taxable person's own transactions: C-354/03 Optigen Ltd v Customs and Excise Commissioners [2006] ECR I-483. "

25. During the course of the hearing, there was, unsurprisingly, considerable attention paid to certain passages in the judgment of Moses LJ in *Mobilx*. However, it was accepted by Mr Benson QC, on behalf of HMRC, that *Mobilx* established that merely proving that the Appellants were aware of the risk of VAT fraud was insufficient. Instead, Mr Benson acknowledged that HMRC needed to prove that the Appellants should have known that its transactions *were* connected to VAT fraud.

26. It was also common ground between the parties that the standard of proof was the usual standard in civil proceedings, viz the balance of probabilities.

27. Mr Scorey, on behalf of the Appellants, accepted that *Mobilx* had established that the ultimate question for this Tribunal is not whether the Appellants exercised reasonable due diligence but whether they should have known that their transactions were connected to the fraudulent evasion of VAT.

28. We shall deal in more detail with the submissions of the parties later in this decision.

The Appellants – background

29. These appeals are somewhat different from a number of other MTIC appeals. Very frequently, in those appeals, the appellant is a newly established company which has recently registered for VAT and within a short period achieves a high turnover, often in goods such as mobile telephones or computer components such as CPUs.

30. In these appeals, however, the Appellants are established traders. As already noted, the Appellants are subsidiaries of the Kanta group. As well as the business carried on by the Appellants, the Kanta group owns property refurbishment and property investment businesses.

31. Davis & Dann was incorporated in 1965 and has been registered for VAT since the tax was introduced on 1 April 1973. It was acquired by the Kanta group in 1983 (following the establishment of Kanta in 1982). The directors of Kanta incorporated Precis in June 1991 and it became a subsidiary of Kanta shortly thereafter. Mr Satish Chatwani and Mr Rashmi Chatwani were directors of both Appellants at the times material to these appeals. Mr Rakesh Tailor was employed as a manager of both Appellants.

32. With the exception of some trading in beverages, confectionery, tyres and metals, the Appellants' principal business activities have involved trading in the household goods sub-sector of the so-called "fast moving consumer goods" ("FMCG") market. FMCG are mainly non-food items (although not exclusively so) and tend to be high-value and in great demand.

33. Davis & Dann operate as authorised distributors on behalf of certain manufacturers. In addition, the Appellants carry on a business in trading in the grey market. Although the Appellants (particularly Davis & Dann) are recognised traders in household goods, they also carry out business in the soft drinks sector, mainly through relationships with grey market traders in Red Bull and Coca-Cola.

34. Davis & Dann undertakes three types of business:

(1) retail sales i.e. warehouse sales and deliveries to smaller establishments in the London and south-east area. This wholesaling business supplies smaller independent retailers. It does not deal with large supermarket chains such as Tesco, Sainsbury's and Asda;

(2) bulk sales; and

(3) export sales.

35. The retail business distributes approximately 6000 product lines, mainly in the chemist, sundries and toiletries sector. Davis & Dann operates a warehouse from which it supplies its retailers. At any one time, goods to the value of approximately £500,000 will typically be stored in the warehouse, with approximately £2m to £3m worth of goods being on the high seas, otherwise in transit or stored elsewhere.

36. Except where it intended to sell stock from its warehouse, Davis & Dann did not hold stock for lengthy periods in order to avoid tying up its capital. Moreover two of the most significant risks experienced by traders in the FMCG sector were the risk of what was described as inventory "shrinkage" (due, principally, to theft) and the risk of packaging changes by manufacturers rendering existing stock obsolete. The retail business, therefore, aimed to have a quick turnover in stock.

37. The disputed transactions related to the bulk/export business. They did not form part of the UK wholesale/retail business.

38. Precis was originally acquired as an off-the-shelf company mainly in order to acquire the share capital of F Copson Plc, a listed company owning a number of plumbers' merchant companies. The acquisition was duly made on 25 October 1991.

All the subsidiaries of F Copson Plc were ultimately sold off by Kanta and, as a result, Precis then had no active use. It was later decided to use Precis as an offshoot of Davis & Dann, so that Precis would ultimately handle the bulk and export sales and Davis & Dann would handle the UK retail sales. Accordingly, until the transactions in respect of this appeal, Precis had done a very limited amount of trading.

39. One reason why Precis was used in respect of some of these deals was that it had carried forward corporation tax losses which could be set off against profits arising from these transactions. According to Mr Satish Chatwani, Precis had not ceased to carry on a trade and therefore these losses were available for carry forward.

Appellants' export/grey market trading

40. The export business of Davis & Dann had grown substantially since it was taken over by Kanta. The growth in this business had been recognised by the award of the Queens Award for International Trade to Davis & Dann in both 1997 and 2002.

41. In the year ended 30 April 2003, 81% of Davis & Dann's total sales by value were from export trade. Similar levels occurred in the years ended 30 April 2004 and 2006. By contrast, in the years ended 30 April 2005 and 2007, exports were lower, principally because the weak US dollar made Sterling more expensive. The analysis of turnover was as follows:

Year Ended	**Till/Deliveries**	**Exports**	**Bulk Sales**	**Total**
30/4/07	£2,693,359 13%	£8,077,850 38%	£10,335,011 49%	£21,106,220 100%
30/4/06	£2,567,595 6%	£29,503,604 72%	£9,181,962 22%	£41,253,161 100%
30/4/05	£2,540,669 13%	£9,801,779 48%	£7,881,907 39%	£20,224,355 100%
30/4/04	£2,840,892 8%	£26,719,566 74%	£6,499,483 18%	£36,059,941 100%

30/4/03	£2,921,931 12%	£19,499,710 81%	£1,801,364 7%	£24,223,005 100%

42. Thus, in the year ending 30 April 2006 the disputed deals (concluded in a three-week period in April) constituted 42% of Davis & Dann's turnover.

43. Davis & Dann would buy, import, sell and export most goods worldwide. However, its business was mainly focused on household goods and toiletries. Davis & Dann and Precis never dealt in mobile telephones or computer chips.

44. It was common ground that there was a legitimate grey or secondary market in the trading of FMCGs. The grey market is the market whereby goods are sold outside normal authorised distribution channels and has existed for many years.

45. The Appellants had considerable experience in dealing in FMCGs in the grey market. Grey market trading was governed by a number of factors: primarily supply and demand, market forces and exchange rates. These factors could lead to manufacturers having a surplus of particular goods, for example because their distributors had over-ordered or because the exchange rate between Sterling, the Euro and the US Dollar had fluctuated, and the manufacturer was unable to simply to alter its prices. In such a situation, the manufacturer would release surplus products outside their normal distribution channels in order to reduce the amount of excess stock. Alternatively, the manufacturer would offer discounted goods to particular authorised distributors on the basis if these distributors would take larger than usual quantities of such goods. These distributors would, in turn, offer the same goods to other distributors and customers in order to sell the stock. This was, in essence, the grey market. Many of the major UK supermarket chains have special buying departments that deal only with grey market goods.

46. The existence of the grey market can also be the result of manufacturers having different pricing policies in different markets worldwide. This arises because some foreign markets are relatively poorer than the UK market and therefore prices in that market have to be set at a lower level than in the UK. For example, in a well-publicised case, Tesco sourced Levi jeans indirectly from an overseas distributor (where the price of the product was much cheaper than in the UK) and sold the jeans to their customers at greatly reduced prices.

47. Davis & Dann would buy stock on the grey market on an irregular basis when there was a particular supply available in the market which they believed would yield a profit or where a buyer was seeking to obtain a specific number and quantity of goods. Davis & Dann would regularly buy from different suppliers, seeking out the best deals available in the market. Davis & Dann would either seek out potential suppliers or would receive unsolicited offers. The transactions were essentially opportunistic – they would buy as and when an opportunity for profit presented itself.

48. For example, between 2006 and 2011, Davis & Dann purchased over £11.5 million of the beverage “Red Bull” from grey market sources. From April 2006 to March 2011 Davis & Dann purchased Coca-Cola to the value of £61,155,817 on the grey market from an authorised distributor. In one sample month (October 2010) Davis & Dann made purchases of Coca-Cola on the grey market to the value of £1,757,127.20.

49. Mr Tailor's evidence was that the Appellants had also conducted millions of US dollars of business in Kimberly-Clark products i.e. Huggies nappies. One shipment comprised approximately 175 containers each 40 foot in length on one ship bound for the USA. These products were supplied by an authorised distributor in Africa.

50. The Appellants accepted that, at the time they entered into the disputed transactions, they had a general awareness of MTIC fraud.

51. Mr Tailor, an experienced manager of the Appellants, told us that he kept abreast with market trends by researching trade websites, trade magazines and speaking with others in the industry. He also corresponded regularly with suppliers and customers and, in order to unlock the potential for export opportunities, he travelled internationally to identify and meet potential customers and suppliers.

52. As well as being experienced grey market traders, the Appellants had direct accounts with and were authorised distributors for a variety of major FMCGs manufacturers in jurisdictions outside the UK.

The razor blades

53. As already noted, all the razor blades in the disputed deals were M3 Power blades, manufactured by Gillette. The M3 Power blades came onto the market in 2004. M3 Power blades were produced to be used with an M3 Power razor, a particular kind of razor which has a battery so that the head moves. The M3 Power blades could also be used on the M3 manual razor. The M3 Power blade was a premium product in the sense that it was more expensive than other products in the M3 range of razor blades. In 2006, according to the evidence of Ms Jones, there were three models in the M3 range:

(1) the original M3: this product was the oldest model; it was the cheapest and therefore sold in the highest volumes;

(2) the M3 Turbo: this product was the second oldest model in the range; it was in the middle of the range in terms of pricing and sales volumes; and

(3) the M3 Power: this product was launched last; it was the most expensive in the range and therefore sold in the lowest volumes.

54. The M3 range of blades (including the M3 Power blades) came in different levels of packaging. The individual retail unit, which would be bought by consumers, was called a "retail pack." A retail pack contained either four blades or eight blades, which were contained in a plastic cartridge with cardboard outer packaging. Gillette always

shipped retail units in retail packs with cardboard outer packaging. Hygiene and safety rules would prevent blade edges being shipped only in the plastic cartridge.

55. Ten retail packs would be contained in an "inner case", which is a small cardboard box. The inner cases are then packaged in an “outer case”. Each outer case would contain 40 inner cases of four blade retail packs or 20 inner cases of eight blade retail packs are involved. Therefore, an outer case would always contain 1,600 razor blades.

The defaulting trader – Leeming

56. As already noted, it was common ground that Leeming was a fraudulent defaulting trader.

57. Leeming had failed to submit VAT returns for the relevant VAT periods i.e. 12/05, 03/06 and 06/06. All the disputed deals took place in Leeming's VAT period 06/06. Assessments in respect of VAT periods ending September 2005, December 2005, March 2006 and June 2006, totalling £15,289,220.82 have been made against Leeming. These assessments have not been paid and attempts to contact Leeming have been unsuccessful.

58. Leeming was deregistered for VAT from 14 March 2006 (although this was later corrected to 13 July 2006 to rectify an administrative error).

59. As noted, during the course of the hearing, the Appellants accepted that the tax loss resulting from Leeming's fraudulent evasion of VAT was continuing.

History of earlier transactions

Gillette razor blade deals in May and June 2003

60. In May and June 2003, Davis & Dann had purchased (in four transactions) large quantities of Gillette M3 Turbo razor blades from a UK supplier. Davis & Dann sold the razor blades to a customer based in another member state. Davis & Dann had been approached by its supplier and by its EU based customer.

61. These purchases resulted in a visit by HMRC officers (Mr Sanger and Mr Yule) to the premises of Davis & Dann on 10 June 2003 where they met Mr Satish Chatwani, Mr Basker Tailor and Mr Rakesh Tailor. At this visit, the HMRC officers discussed the M3 Turbo razor transactions in detail with Mr Rakesh Tailor.

62. Davis & Dann were requested to validate all VAT registration numbers with HMRC. Mr Sanger advised Davis & Dann of the problems in mobile phones and CPUs and noted that the problem had moved into other areas such as razors.

63. According to Mr Sanger's note of the meeting, Davis & Dann stated that if there were any missing traders in the deal chains they would not undertake the transaction.

64. In cross-examination Mr Satish Chatwani confirmed that to the best of his knowledge Davis & Dann never traded with the supplier or customer again.

65. The meeting was followed by a telephone call from another HMRC officer, Mr Gordon Young, to Mr Satish Chatwani on 11 June 2003.

66. According to Mr Young's note of the conversation there was a lengthy discussion. Mr Young was calling at the request of Mr Sanger in relation to a VAT registration verification request by Davis & Dann in respect of two traders. Mr Young's note records the following:

> "Call commenced 1240 hours…Spoke about Officers[sic] visit of previous day. I explained to Mr [Chatwani] that verification was not just a question of saying whether his supplier had a valid VRM but that I would be chasing the chain back to establish if there was a missing trader or hijack in the chain with an ensuing tax loss. I said that because of the previous trades he had done like the ones on offer today there was virtually no doubt that the chains will start with the tax loss and this could seriously affect his entitlement to reclaim IT and as he was an exporter this would be a lot (around £220k).
>
> Mr [Chatwani] mentioned that he had read the budget provisions relating to J & SL [Joint and Several Liability] etc and he saw that they applied to specific trade class goods. I said yes they did but if we could demonstrate that the specific goods he was dealing in on these trades were merely going around in a circle then we might decide that the activity is non-economic. I explained what I understood a taxable supply to be and how a series of transactions even if there was a supply for a consideration might be deemed to be devoid of economic substance, so even if he had all the evidence he thought would make his claim to IT cast-iron, he might still be refused it. He seemed taken aback at this and very confident of his knowledge of the law relating to IT. I drew his attention to the Bond House ruling to illustrate what I meant by devoid of economic substance. I also told him that I knew enough about the chains on the deals already done to be fairly certain that there was evidence of the circularity of goods.
>
> I pointed out to Mr [Chatwani] that I thought it odd he troubled himself to read the budget provisions on CPUs and phones when he did not deal in those goods. He said as a long-standing company he would apprise himself of all new tax regulations. I said it was odd that he had read the new rules and then the trade in razor blades had commenced five days after the budget. I asked why he thought the rules might have any bearing on this new trade. He said he didn't think it did. I asked if he had traded in this product to this extent before and he admitted he had not, that it was effectively new to him. I asked about the background to the deals with regard to how he had found a customer and supplier wanting large quantities of the same product at the same time when previously his company did not have a profile for dealing in these goods. I put it to Mr [Chawani] that what had happened was probably that someone had offered him the product out of the blue and then another company had called him asking if he could source the stock. He said that was in fact the case. I said well is that not a little coincidental then and did he not feel that perhaps he had been manoeuvred into the middle of a deal. He agreed.

> Mr [Chatwani] was very worried about his repayment on the previous deals. He said his normal repayment was around £20k and a lot of his business was outside the scope. I said if you suddenly had a repayment for £220k then it would probably have generated a query anyway and it was better that matters had come to light now. I explained that the issue of his repayment claim could be dealt with by his local office but I would give a report of this conversation to Mr Sanger.
>
> Mr [Chatwani] mentioned that he was an accountant and that his company had won the Queen's Award for Exports. He said that in relation to the razor blades deals his brother had set them up. I also mentioned to Mr [Chatwani] that other types of goods might be used such as pregnancy testing kits, batteries etc but that the deals would probably have the same characteristics as the razor blades deals in terms of quantity, value, the manner of approach by supplier and customer etc and it should be relatively straightforward to him to differentiate between that sort of trade and his normal day-to-day trade and that he should continue to verify any deals falling into that category. I said as an exercise I would check back on the goods he was being offered today and established that if a missing trader or hijack was involved. He said he would think about it.
>
> 1315 Mr C called back. Said he had decided not to do the deal. I advised him that this was a commercial decision for himself and that C & E would not tell him who to trade with. I reiterated I was more than happy to trace deals back. He said if he considered any further such deals he would call me first.
>
> 1425 Call from Mr Phil Hazel of KPMG. He represents Davis & Dann. Discussed the general issue. Discussed issue of return which was submitted last week. Explained it had probably not even been considered yet but that it would probably be referred to the local office for verification."

67. In cross-examination it was put to Mr Young that he had not in fact informed Mr Chatwani during this conversation that any previous transactions had in fact been connected with fraud. Mr Young replied that he had said to Mr Chatwani that, based on what he had seen of his previous trades, he had no doubt that there would be a tax loss in the particular trade that they were talking about. He could not be sure whether he gave any more detail than that.

68. Mr Young's attention was drawn to the portion of his note where Mr Young stated that he put a certain scenario to Mr Chatwani about being contacted by one party and then quickly by another. It was suggested to Mr Young that, because Mr Chatwani was an accountant who did not personally do the deals himself, that he had not put it to Mr Chatwani in those terms and that Mr Chatwani had not agreed. Mr Young replied by noting what he had recorded. However, he noted that on the next page of his note it states that Mr Chatwani's brother dealt with the particular transactions and Mr Young commented that those two things "might seem at odds."

69. In examination in chief, Mr Satish Chatwani stated that during his telephone conversation with Mr Young he had not been told that prior deals carried out by Davis

& Dann were connected with fraud. Mr Chatwani referred to the note of the meeting the previous day with Mr Sanger where the note records:

> "The trader also stated that if there were any missing traders in the chains that they would not undertake the transaction."

70. Mr Chatwani also explained that he was a chartered accountant but that he took an interest in tax and tax compliance matters (the Appellants did their own tax compliance work). He described his interest in tax as a hobby and a personal interest and, for this reason, he had read the provisions relating to joint and several liability referred to in the note of the telephone conversation with Mr Young.

71. Mr Chatwani also denied that he had said that the Appellant had not traded in Gillette razor blades before.

72. Mr Chatwani was referred to the paragraph in Mr Young's telephone note which read:

> "I put it to Mr C that what had happened was probably that someone had offered him the product out of the blue and another company had called him asking him if he could source the stock. He said that that was in fact the case."

73. Mr Chatwani denied having made this statement to Mr Young because Mr Chatwani said he had never been involved in doing the deals. He observed that, in the note of the meeting with Mr Sanger, all the questions relating to the deals were put to Mr Tailor because he (Mr Chatwani) knew nothing about those deals. Mr Chatwani was challenged on this in cross-examination and accepted that he had not himself made a note of the conversation.

74. We did not consider that Mr Young informed Mr Chatwani that previous deals undertaken by the Appellant had actually been connected with fraud. It is clear, however, that Mr Young was informing Mr Chatwani that he considered that the deal currently under consideration by Davis & Dann and the previous deals were likely ("virtually no doubt") to trace back to a tax loss and, therefore, be connected with fraud. Mr Young's note draws a comparison between the deal that was then under consideration and the earlier trades in the sentence: "I said that *because of the previous trades he had done like the ones on offer today* there was virtually no doubt that the changes would start with the tax loss…." (emphasis added) In our view, the linking of the current deal and the previous deals carried the clear implication (and a warning) that the previous deals were likely to have been connected with fraud. There was, however, no statement or notification that the deals were in fact connected with fraud.

75. As regards the scenario recorded in Mr Young's note about someone calling out of the blue and offering stock followed by another company calling to enquire whether the stock could be sourced (which, according to Mr Young’s note, Mr Chatwani agreed had happened), we consider that it is more likely than not that the conversation took place as recorded in Mr Young's note. We consider that after eight years, the note of the telephone conversation was more likely to be accurate than Mr Chatwani's

recollection. We do not consider the fact that Mr Chatwani was not involved in doing the deals necessarily made the note of the conversation on this point implausible. Mr Chatwani accepted that when talking to HMRC he would arrange for the appropriate personnel to attend the relevant meeting so that information could be given first-hand. It seemed to us that the fact that Mr Chatwani was not personally involved in the deals did not necessarily mean that he did not know from others how the deals had come about.

76. In cross-examination, Mr Chatwani also denied having said to Mr Young that Davis & Dann's "normal repayment was around £20k." Mr Chatwani stated that the average repayment for 2003 was around £80,000. We do not have the repayment figures for the full 2003 year. However, the repayment figures for the three VAT periods prior to the deals entered into in May, June and July 2003 were: February 2003 £45,682.32, March 2003 £25,348.76, April 2003 £14,848.42. Again, we consider Mr Young's note to be a more reliable record of what was said that Mr Chatwani's recollection after eight years. In any event, it is quite probable in our view that Mr Chatwani had the most recent repayment amounts in mind when making an estimate of normal repayments in his conversation with Mr Young.

77. In preferring Mr Young's version of the telephone conversation (as recorded in his note) to Mr Chatwani's recollection, we wish to make it clear that we do not consider Mr Chatwani to have been untruthful, but simply that his recollection was more likely to be mistaken than Mr Young's note.

78. The telephone conversation between Mr Chatwani and Mr Young was followed by a letter from Davis & Dann (Mr B Tailor) dated 1 July 2003 which concluded by stating:

> "Please note that since the date of your visit and our subsequent discussions we have to date not entered into any further large back to back transactions, where the exports are to Europe."

79. That letter dealt with the invoices relating to Gillette razor blades, pregnancy testing kits and fertility monitors. It is plain from this letter that the Appellants were on notice that large back-to-back razor blade deals where the goods were to be exported to Europe called for particular care in respect of MTIC fraud.

Platinum XXX card deals in July 2003

80. In July 2003, Davis & Dann entered into back-to-back deals in Platinum XXX cards – cards which gave access to pornographic websites. Davis & Dann exported the cards. These transactions put Davis & Dann in a VAT repayment position.

81. By a letter dated 6 November 2003, HMRC informed Davis & Dann that its deals had been traced back to hijacked VAT registration numbers, with payments being made to third parties.

82. Ms Okolo accepted that HMRC had not written a similar letter to Davis & Dann in respect of the earlier Gillette razor blade deals in May and June 2003.

83. On 15 December 2003, HMRC informed Davis & Dann's agents that the repayment claim would be paid in full on a "without prejudice" basis. The amount of the repayment claim was £234,570.

84. The Appellants did not trade in Platinum XXX cards after July 2003.

Level of repayment claims

85. Ms Okolo exhibited to her witness statement schedules giving details of VAT repayment claims made by Davis & Dann for the period February 2003 to the period October 2006 and for Precis for the periods September 2004 to September 2006. The figures were as follows:

VAT period	VAT reclaimed (£) Davis & Dann	VAT reclaimed (£) Precis
February 2003	45,682.32	
March 2003	25,348.67	
April 2003	14,848.42	
May 2003	355,453.52	
June 2003	350,587.51	
July 2003	263,142.08	
August 2003	35,457.71	
September 2003	20,509.65	
October 2003	48,989.25	
November 2003	-5,053.61	
December 2003	63,874.41	
January 2004	-5,480.53	
February 2004	37,635.75	
March 2004	34,142.55	
April 2004	-54,698.11	
May 2004	63,189.20	

June 2004	18,991.22	
July 2004	23,223.38	
August 2004	41,643.31	
September 2004	9,605.42	-10,312.15
October 2004	52,482.73	–
November 2004	30,029.28	–
December 2004	37,720.32	–
January 2005	24,362.97	–
February 2005	- 23,072.32	–
March 2005	21,423.43	–
April 2005	16,302.37	–
May 2005	43,841.18	–
June 2005	92,040.98	–
July 2005	15,092.52	–
August 2005	23,753.76	–
September 2005	13,661.51	–
October 2005	54,007.27	–
November 2005	30,823.59	–
December 2005	15,885.90	–
January 2006	13,820.10	7,372.13
February 2006	463,700.76	14,744.26
March 2006	1,052,930.39	7,372.13
April 2006	2,169,781.91*	1,125,262.79*
May 2006	-6707.03	1,087,269.44*
June 2006	67,589.19	–

July 2006	7242.39	12,227.10
August 2006	43,147.60	7,559.24
September 2006	-8,196.09	251.02
October 2006	13,608.63	

*Reclaims include amounts subject to these appeals

N.b. negative figures indicate amounts owed by trader

86. It will be seen that the Gillette razor blade deals in May and June 2003 and the Platinum XXX card deals in July 2003 and the M3 Power deals in April 2006 put Davis & Dann in an unusually large repayment position. Similarly, the M3 Power deals in April and May 2006 put Precis in a similar unusual repayment position.

87. The large reclaims for Davis & Dann in February and March 2006 also related to Gillette M3 Power razor blade deals where the supplier was Bristol. In February and March 2006, the Appellants bought a total of 8,032,000 M3 Power razor blades (5,020 outer cases) from Bristol. The invoices for the first two transactions were dated 9 February 2006. HMRC made the repayment in respect of February 2006 on a "without prejudice" basis. Ms Okolo stated in cross-examination that HMRC knew there was something wrong with the transactions, but the Department was short of staff and therefore the repayment had been made, but on a "without prejudice" basis. Ms Okolo accepted that, in respect of the February and March 2006 deals, apart from being told that the February repayment was being made without prejudice, the Appellants received no notification from HMRC that those transactions were connected with the fraudulent evasion of VAT.

88. Davis & Dann submitted VAT returns on a monthly basis and did so even before it was acquired by Kanta. Precis initially submitted its VAT returns on a quarterly basis. However, from 1 January 2003, HMRC allowed Precis to submit monthly returns. There was nothing untoward in the fact that, as an established exporter, the Appellants submitted monthly returns and HMRC did not suggest otherwise.

Bristol Cash & Carry – the supplier

Dealings with Bristol

89. The Appellants received an unsolicited introductory fax from Bristol (Mr Paul Singh) on or around 11 January 2006. Mr Tailor and Mr Rashmi Chatwani accepted that they had never heard of Bristol before. The fax was headed: "FAO: DRINKS BUYER." The fax noted that Bristol was an independent wholesaler serving convenience stores and off-licences in and around Bristol. The fax continued:

> "We are one of the largest independent wholesalers in the South West region. Being independent we offer customers a wide choice of wines, spirits, beers, ciders and soft drinks.

> We also offer wholesale to wholesale trading at high volumes with excellent pricing and logistics to suit your company's requirement.
>
> As a truly composite drinks wholesale operation, Bristol Cash and Carry offers a total product portfolio of over 900 different products. The business is particularly strong in the categories of beers, wine, spirits and soft drinks.
>
> Given the strengths and scale of Bristol Cash and Carry it is able to offer a strong portfolio of products and brands available from any wholesale operation. The quality of the products and brands available stretches across all drinks categories from wine, spirits and beers to soft drinks and bottled water."

90. The fax continued by emphasising Bristol's "exceptional infrastructure" and its competitive pricing. It concluded by stating: "Our vision is to become the largest diversified drinks group in the region…."

91. The Appellants regularly received unsolicited offers of business from other companies to which either Mr Tailor or Mr Rashmi Chatwani would reply. Mr Tailor estimated that the Appellants received one or two communications a day from potential new customers. Mr Rashmi Chatwani confirmed that several unsolicited approaches could be received in one day. On this occasion Mr Rashmi Chatwani asked Mr Tailor to contact Bristol to see what they had to offer or what, if anything, they could buy from the Appellants.

92. Mr Tailor contacted Bristol and spoke to Mr Paul Singh, the managing director of Bristol. They discuss the possibilities of doing business together.

93. Mr Singh provided Mr Tailor with company details which showed that Bristol Cash & Carry was the trading name of a company called Famecraft Limited.

94. In accordance with the Appellants' standard practice, Mr Tailor ran a credit check on Famecraft Limited using the facilities offered by Risk Disk, an online credit rating agency.

95. The Risk Disk report showed that Bristol was a non-trading company and recommended that further enquiries be made before offering the company credit. The version of the Risk Disk report in our papers contain the legends: "Report printed: 16 February 2006" and "05.05.06:19/01/2006." The report noted the last return date for Famecraft Limited as being 2 April 2005 and the last accounting date as being 30 April 2005. From this information it was clear that Bristol had only been in business for a maximum period of less than 12 months. The description of Bristol's business in the report was "wholesale of alcoholic and other beverages." There was no mention of toiletries or razor blades.

96. In his evidence, Mr Tailor said that he was not unduly concerned by the report because Bristol could have recommenced business since 2 April 2005 – a possibility mentioned in the report itself. Mr Tailor discussed the report with Mr Rashmi Chatwani and it was agreed that Mr Tailor should visit Bristol's premises. Mr Rashmi Chatwani said that, because he was not intending to extend credit to Bristol, its credit

rating was not important. Mr Chatwani considered that there was nothing in the report to suggest that Bristol was anything other than a legitimate company – there was no adverse history to suggest it might be an illegitimate or defaulting trader.

97. Mr Tailor spoke to Mr Singh on further occasions concerning general business opportunities and also replied to him by way of fax dated 23 January 2006. Mr Tailor's fax read as follows:

> "Dear Mr Singh
>
> Further to your fax and various telephone conversations, thank you for taking the trouble to speak to me.
>
> I would advise you that Davis & Dann Limited is a Trading and Distribution Company, based in the UK, with distribution within the UK and various markets overseas. Its strength is being able to identify export lines for our export and prospective clients and being able to source and supply those products at competitive prices.
>
> With this in mind, we are always searching for new suppliers and would advise you that at present, we do deal in a number of soft drinks, including brands such as, Coca-Cola, Pepsi and Red Bull, and in the past, we have sourced and supplied wines and spirits to our customers as well.
>
> We would be delighted to receive your offers and, with this in mind, I enclose a completed Trading Application Form, which gives full details, and I look forward to your confirmation that all is in order.
>
> At present, we are looking to source Red Bull for one of our export clients and can purchase large quantities immediately. Please do contact us, if you have any availability.
>
> I look forward to hearing from you.
>
> Kind regards
>
> Rakesh Tailor
>
> General Manager"

98. It is clear that at the date of this fax the discussions between the parties concerned drinks rather than razor blades. Mr Tailor in cross-examination doubted whether there had been a serious conversation about razor blades by 23 January 2006. The date is important because the first contact from CEMSA was on 27 January 2006.

99. Mr Tailor visited Bristol's premises on or around 31 January 2006. He was given a guided tour of the premises he observed that Bristol's warehouse contained a large amount of stock and that there was significant commercial activity taking place. He observed staff picking orders (that is, selecting products from the warehouse against customer orders) and despatching consignments. His evidence was that he was left in no doubt that, even if Bristol had only recently started trading, it was a bona fide enterprise.

100. Mr Tailor also discussed with Mr Singh the respective businesses of Davis & Dann and Precis, and Bristol. From this discussion he was satisfied that Bristol was a

company that was looking to develop its business by creating new long-term relationships with purchases of certain products, including toiletries. Mr Tailor did not, however, ask Mr Singh how long Bristol had been in business.

101. Mr Tailor informed Mr Singh of terms on which the Appellants would be willing to do business with new suppliers. For example, the Appellants would only pay for goods once they had received them into their possession. He informed Mr Singh that Davis & Dann was a well-established business and invited Mr Singh to perform any checks (e.g. credit checks) that he thought necessary. Mr Tailor said that he formed the view that Bristol was a credible business partner and that they shared a desire to find opportunities to develop a business relationship.

102. During the visit, Mr Tailor discussed with Mr Singh the type of goods in which Davis & Dann was interested. Potential synergies were noted in respect of toiletries. In particular, Mr Singh mentioned Gillette products and Mr Tailor indicated that the Appellants would always be interested in those products. Mr Tailor did not, however, test Mr Singh to see whether he had any particular expertise in relation to Gillette products.

103. Shortly after this meeting the Appellants received Bristol's first offer of Gillette razor blades. The offer was for goods located at the premises of a freight forwarder named 1st Freight.

104. Mr Tailor, on receiving this offer, checked Gillette's standard price list (to which Davis & Dann had access because it held a direct account with Gillette). He also telephoned various wholesalers and traders. He came to the conclusion, in the light of the then current market price, that Bristol's price was too high. Mr Tailor wrote to Mr Singh explaining that his price was too high and Mr Singh subsequently replied with a revised offer. Ultimately, the price was about £4.38 per unit. In Mr Tailor's view this compared favourably with the net list price of £4.81, representing a reasonable discount of approximately 9%, which Mr Tailor considered not unusual in the grey market.

105. Mr Tailor asked Mr Singh how he had got hold of these Gillette razor blades. He said that he had connections which meant that he was able to get hold of these razor blades.

106. Mr Tailor discussed the offer with Mr Rashmi Chatwani. It was decided to offer the stock to four different customers, including CEMSA. The customers were all in Europe: one was in Belgium, another in Switzerland and another in the UK. The UK customer said that it had sufficient stock, but asked for time to see if it could sell it on. Swiss customer said he had no interest. And the Belgian customer asked for more information and said they would get back to the Appellants in due course, but were very interested. Mr Tailor explained that the offer would be "first come first served". Mr Tailor said that Mr Rashmi Chatwani had indicated that in his own conversations with CEMSA they had mentioned that they had a demand for Gillette products.

107. Mr Tailor telephoned Mr Singh and told him that a transaction could only take place after the goods had been inspected. Mr Singh arranged for Mr Tailor to inspect the goods at the premises of Bristol's freight forwarder.

108. In the meantime, CEMSA had offered to purchase the razor blades.

109. Mr Tailor contacted Bristol to confirm his interest in the goods, subject to a satisfactory inspection. At Mr Singh's request, Mr Tailor telephoned 1st Freight and it was agreed that he could travel immediately to their premises to view the goods.

110. Mr Tailor visited 1st Freight and were shown the area where Bristol's consignment was stored. Mr Tailor requested that the shrink wrapping on the palates be removed. He counted the entire consignment. He personally inspected the stock. He chose several boxes at random in order to perform a full physical examination. A box was opened so that Mr Tailor could examine the contents in detail. The inner boxes were identical to the ones the Appellants bought directly from Gillette. Mr Tailor opened one of the inner boxes and examined the retail pack (containing four blades). From his examination, Mr Tailor was satisfied that the goods existed and that they were genuine Gillette products.

111. Mr Tailor took photographs of the goods.

112. Mr Tailor acknowledged that he knew Bristol was not an authorised distributor of Gillette products.

Credit terms

113. In cross-examination, Mr Rashmi Chatwani accepted that, in 18 out of the 20 deals that the Appellants entered into with Bristol, the Appellants did not pay Bristol until they themselves had been paid. Mr Chatwani accepted that either Bristol was funding the credit extended to the Appellants itself or someone was extending credit to Bristol. Mr Chatwani said that he did not find it suspicious that a company that had been running for only nine or ten months was either able to find the cash to pay for the goods supplied in 18 of the 20 deals or that someone was prepared to extend credit. He thought it was possible that they might have their own financing arrangement. He considered that that was normal in that kind of business. The fact that Bristol was prepared to extend credit indicated they had done their due diligence on Davis & Dann. Mr Chatwani denied that the agreement with Bristol was that the Appellants did not have to pay Bristol until they themselves have been paid. Instead he believed that the credit terms would have specified a number of days, although he could not recall exactly what the period was.

Section 77 A Value Added Tax Act 1994 Declaration ("Section 77A declaration")

114. Before dealing with Bristol, the Appellants required Bristol to complete a declaration. The specimen declaration we were provided with was dated 27 April 2006 and read as follows:

"DECLARATION

These goods are supplied to you at the current market price and we are not selling to you at a lower price than we purchased from our supplier (s) and if for any reason we do sell at a price lower than our purchase price it is because of market conditions.

The goods specified on the above invoice number have been subject to examination by us (or our agents) and we are satisfied that these goods exist and are as per our description on the invoice.

We have not entered into any third-party payments with our supplier.

We have no grounds to suspect that the relevant VAT on these goods has not been paid by our supplier.

We confirm that the relevant VAT will be declared on our sale to you.

We confirm that we have carried out reasonable due diligence checks on our supply of the goods mentioned in the invoices above and have conducted further enquiries into the background of our supplier and are satisfied that these checks constitute reasonable enquiries as required by Section 77A VAT act [sic] 1994 and in accordance with the consultation document provided by HM Customs dated April 2003.

I certify that I am authorised to sign this declaration on behalf of the company and to the best of my knowledge the information provided is true and complete."

115. The document was signed by Mr Singh on behalf of Bristol.

116. Section 77A VAT Act 1994 dealt with the circumstances in which a trader could be held to be joint and severally liable where the trader knew or had reasonable grounds to suspect that VAT may have gone unpaid in the supply chain. The provision related to telephone/telecommunications equipment and computer equipment.

117. Mr Benson submitted that the requirement that Bristol gives such a declaration demonstrated that the Appellants suspected that their transactions were connected with fraud or, at the very least, suspected that their transactions might be connected with fraud. Mr Benson noted that Section 77A VAT Act 1994 applied only to mobile telephones and computer components and not to razor blades.

118. Mr Satish Chatwani's evidence was that the declaration was used on the advice of their advisers, KPMG. Mr Chatwani acknowledged that Section 77A VAT Act 1994 did not apply to razor blades but noted that MTIC fraud had spread to other commodities. He described the use of the declaration as "belt and braces". He had advised the Appellants' operations department to ask large, non-manufacturing suppliers to sign these declarations.

119. Mr Rashmi Chatwani stated that the declaration had also been used for purchases of Red Bull and Coca-Cola.

120. In our view, no adverse inference should be drawn from the use by the Appellants of a declaration which was, at least in part, inappropriate. We accept Mr Satish Chatwani's evidence that the declaration was used on the advice of KPMG. There is no dispute that the Appellants were aware of the perils of MTIC fraud and that they were aware that the fraud had spread beyond mobile telephones and computer components to other items such as razor blades. We consider that they may well have used the declaration out of caution.

CEMSA – the customer

121. CEMSA, a Spanish incorporated company, was the Appellants' customer in all the deals under appeal.

122. CEMSA had sent the Appellants and introductory fax on 27 January 2006. Mr Rashmi Chatwani replied on 30 January 2006 expressing interest in the possibility of doing business.

123. Mr Steve Russell of CEMSA then telephoned Mr Chatwani on or around 3 February 2006 and they discussed various matters about their respective companies. Mr Chatwani indicated that the Appellants' business was mainly in toiletries and household goods and asked Mr Russell if he was interested in purchasing such items. Mr Russell replied that he was very much interested.

124. Mr Chatwani wrote to Mr Russell again on or around 7 February 2006, acknowledging Mr Russell's telephone call, and expressing the hope that they would be able to do business together.

125. The Appellants checked CEMSA's VAT registration number using the Europa website. The VAT number was genuine. Two Europa reports were provided by Davis & Dann to HMRC confirming CEMSA's VAT registration number as valid. The reports were dated 8 February 2006 and 28 June 2006.

126. The Appellant carried out a Dunn & Bradstreet credit check on CEMSA. Mr Chatwani stated that he had received the report in February 2006, although the copy exhibited as evidence was dated 19 May 2006. The report rated CEMSA with a score of 19 where 1 represented the highest risk and 100 the lowest risk.

127. Although it was not possible to visit CEMSA before the Appellants commenced a trading relationship, Mr Chatwani arranged to visit CEMSA at their offices in Marbella on 6 April 2006. Mr Chatwani combined this visit with a family holiday. At CEMSA's offices Mr Chatwani met members of CEMSA's staff. Mr Russell was not present, but Mr Chatwani had dinner with him later that day.

128. Mr Chatwani observed that CEMSA's offices appeared to be busy, with telephone calls and faxes being sent and received. He noted that there were shelves filled with samples of merchandise. Mr Chatwani took photographs of his visit to the CEMSA's offices.

129. CEMSA's registration documents were examined. Mr Chatwani's Peruvian secretary (a native Spanish speaker) was able to help with the Spanish translation. Mr Chatwani was satisfied that CEMSA was a properly constituted company.

130. Mr Chatwani was advised by CEMSA that it was an established company, having been in existence since the 1990s with a turnover of millions of euros. Nonetheless, Mr Chatwani did not feel able to extend credit to CEMSA and agreed with CEMSA that it would pay for the razor blades prior to delivery. In particular, CEMSA asked Mr Tailor whether the Appellants would be willing to ship the goods but only release the goods after payment had been received. Mr Tailor discussed the matter with Mr Rashmi Chatwani. After being satisfied that the freight forwarders were satisfactory, it was agreed that they would do business on that basis. 1st Freight, therefore, shipped the goods on condition that they would not be released until payment had been received. 1st Freight would send the Appellants a copy of the outbound international consignment note (the Convention Merchandises Routiers or "CMRs").

131. The CMRs showed the date and place of loading, place of delivery, a description of the goods (including weight and volume), and the track registration number. The Appellants were also sent a Eurotunnel transport ticket which showed the vehicle leaving the UK. The CMRs exhibited to Mr Rashmi Chatwani's witness statement stated that the goods were "ship on hold."

132. Following the success of the first deal with CEMSA, the Appellants thereafter gave first refusal on similar products to CEMSA.

133. CEMSA completed and returned Davis & Dann's standard terms and conditions which applied to the transactions with the Appellants. The invoices issued by the Appellants confirmed that the Appellants retained title to the goods until fully paid.

134. Once payment had been received from CEMSA, Mr Tailor would fax a release note to1st Freight instructing them to release the goods to CEMSA. The Appellants, having bought on credit terms from Bristol, then arranged for the corresponding payment to be made to Bristol. No third-party payments were made in respect of any of the transactions under appeal.

135. The Appellants refused to agree a sale to CEMSA if payment (and delivery) were still outstanding in respect of an earlier transaction.

136. Although CEMSA was the Appellants' customer, the razor blades were always shipped to GR Distributions in France (a company registered as wholesalers of wood, construction materials and sanitary equipment). CEMSA sold the goods to an Italian company FAF International SRL, although the goods remained physically in France. There was no evidence before us that suggested that the Appellants knew of this onwards sale.

1st Freight

137. As already explained, the M3 Power razor blades were stored at a freight forwarder called 1st Freight and Mr Tailor inspected a consignment of razor blades at1st Freight's warehouse before commencing to trade with Bristol. 1st Freight was the freight forwarder used by Bristol and was not the Appellants' usual freight forwarder.

138. Mr Tailor examined 1st Freight's premises and operations carefully during his visit.

139. He noted that the premises were situated at the back of a Metropolitan Police compound. He considered the location reduce the risk of a robbery. In this context, we were informed that the Appellants' own warehouse had been burgled twice.

140. The areas around the premises and inside the premises were under CCTV surveillance. Mr Tailor was informed that the premises were also alarmed and fully insured.

141. The yard could only be entered through metal gates and its perimeter was surrounded by a brick wall in excess of, approximately, 2m in height. Inside the yard, the door to the warehouse/office was monitored by camera and had an intercom by which visitors had to announce themselves prior to being allowed into the building.

142. Mr Tailor concluded that the premises were very secure and, indeed, were probably more secure, in his opinion, than those of the Appellants' usual freight forwarder.

143. Mr Tailor received assurances that1st Freight would be able to provide secure transport. He was also assured that 1st Freight regularly performed inspections on behalf of their clients including a box count, a visual check of the goods and a random physical inspection of 10% of the merchandise.

144. Having been satisfied that the goods were secure, the Appellants concluded that the risk and cost of transporting goods from one freight forwarder to another should be avoided. The goods were, therefore, left in the possession of 1st Freight.

Volume traded in disputed deals

Volume and value of razor blades traded

145. One of the most hotly disputed issues in this appeal related to the volume of Gillette M3 Power razor blades bought by the Appellants from Bristol and on-sold by the Appellants to CEMSA.

146. The actual quantity of razor blades dealt in was not, in fact, in dispute. It was not disputed that, between 6 April 2006 and 31 May 2006, the Appellants bought and sold 23,184,000 razor blades, packaged in 4,320,000 retail units and 14,449 outer cases for an aggregate price of £24,860,766. Of those 23,184,000, approximately

17,000,000 were dealt in by the Appellants during a 21 day period in April 2006 – the remainder being acquired and sold on 25, 30 and 31 May 2006.

147. According to the evidence before us, the Appellants had not purchased such a large quantity of razor blades (still less a particular type of razor blade) in a similar period of time either before or after the transactions under appeal.

148. The significance of the volume of the particular type of razor blade dealt in by the Appellants was whether this was a factor that should have alerted them to the fact that their transactions were connected to the fraudulent evasion of VAT.

149. Our further findings are as follows.

150. There was no dispute that the M3 Power razor blade was a premium product and, according to the evidence of Victoria Jones, sold in smaller quantities than the basic (cheaper) M3 razor blades. Mr Tailor, in cross-examination, accepted that in Davis & Dann's wholesale business (which sold to small retailers) the demand for such a premium product was small. The wholesale business was not the premium end of the market. He suggested that the position could be different as regards bulk trades, but accepted that it was still necessary for consumers ultimately to buy the products.

151. It seemed to us obvious that the Appellants, from their own experience, would and should have appreciated that the more expensive M3 Power razor blades would sell in smaller quantities than less expensive M3 razor blades.

152. Ms Okolo, in her witness statement, referred to information received by HMRC from Gillette in relation to its worldwide sales of M3 Power razor blades. An e-mail from Gary Pells of Gillette dated 20 July 2006 confirmed that HMRC would be provided with an indication of the numbers of M3 Power blades sold in a year and a number the largest UK customer might take in a year. On 21 August 2006 HMRC received an e-mail from Gillette which advised that Gillette sold approximately 1,250,000 M3 Power cartridges in the UK per month. The largest UK customer would buy around 250,000 M3 Power cartridges per month.

153. On 11 January 2007 Gillette (UK) provided HMRC with worldwide information in relation to sales of M3 Power razor blades ("the Worldwide Sales Schedule"). The information (expressed in millions of units i.e. blade edges) was exhibited to Ms Okolo's witness statement and was as follows:

M3 Power Blades	**Jan 06**	**Feb 06**	**Mar 06**	**Apr 06**	**May 06**	**Jun 06**	**Jul 06**	**Aug 06**	**Sept 06**	**Total**
North America	5.7	5.5	4.4	3.8	3.8	4.9	3.7	3.7	4.7	40.2
Western Europe	5.4	5.4	7.1	4.8	5.2	6.5	4.1	3.9	5.3	47.6
Latin	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

America										
Northeast Asia	0.5	0.4	0.7	0.6	0.6	0.7	0.6	0.6	0.8	5.4
CEEMEA	2.0	1.8	1.5	1.4	1.4	1.1	0.7	0.6	2.8	13.3
AAI	0.3	0.3	0.4	0.3	0.3	0.4	0.0	0.0	0.4	2.3
Greater China	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total global	13.9	13.5	14.1	10.9	11.2	13.7	9.0	8.8	13.9	108.9

154. There appeared to be small mathematical errors, possibly caused by rounding, in the totals for Western Europe, Northeast Asia and AAI.

155. It will be noted that in April 2006 the total worldwide sales of M3 Power razor blades were 10.9 million and in May 2006 11.2 million.

156. The figures were compiled from point-of-sale data in respect of large retailers. The figures appeared not to be production figures. There was some ambiguity in Miss Jones's evidence about whether these figures represented shipments or sales. We consider it more likely that the figures represented global sales. Mr Scorey criticised the figures on the grounds that they did not take into account historic stock that might have built up in the supply chain. They did not, in Mr Scorey's submission, record the M3 Power razor blades by Gillette and actual flow of those products around the world at the relevant time.

157. Nonetheless, the figures taken over nine months show an average of 12.1 million M3 Power razor blades being sold by retailers per month. One would expect build-ups stock to be smoothed out over time, particularly since, as Ms Jones confirmed, Gillette operated a "just-in-time" manufacturing policy to prevent excessive stock building up in the distribution chain. We therefore considered these figures regarding worldwide retail sales as useful objective evidence against which the size and scale of the Appellants' purchases and sales could be measured.

158. On this basis, therefore, in April 2006 (the first 17 deals) the Appellants bought and sold 17.376 million M3 Power razor blades compared with total global sales of M3 Power razor blades of 10.9 million and 4.8million for Western Europe i.e. 159% of the total global sales and 362% of sales for Western Europe. In April and May 2006 the Appellants bought and sold over 100% (approximately 105%) of the total global sales of M3 Power razor blades, bearing in mind that the Appellants undertook transactions on only three days in May 2006 (to the value of £5.808 million). These purchases were in addition to the 8 million M3 Power razor blades brought by the Appellants from Bristol in February and March 2006.

159. The Appellants' purchases and sales of M3 Power razor blades were also very large when compared with retail sales in the UK and Ireland of M3 Power blades – the evidence was provided from Proctor & Gamble's internal database by Ms Jones. Retail sales in the UK and Ireland of M3 Power razor blades in April 2006, amounted to 1,314,000 razor blades, packaged in 272,000 retail packs, which had a value of £2,065,000.

160. Mr Scorey argued that making comparisons with UK and Irish retail figures was misleading since the goods were being transacted on the international grey market and not the UK/Irish domestic market. Nonetheless, we consider that these figures provide a useful objective benchmark to indicate the very large relative scale of the Appellants' transactions.

161. In the years 1998 – 2006 the Appellants regularly bought Gillette razor blades directly from Gillette. The razor blades so purchased comprised various different models i.e. they were not just purchases of M3 Power razor blades. The figures were as follows:

Calendar Year	VAT Inclusive Purchases
1998	£116,019.75
1999	£807,973.90
2000	£1,987,592.47
2001	£247,813.37
2002	£183,150.08
2003	£250,968.45
2004	£173,148.79
2005	£136,606.55
2006	£86,669.72

162. The reason for the increase in turnover in 2000 was because in that year Gillette offered Davis & Dann a special deal. As noted, these figures concerned direct purchases by the Appellants from Gillette. It was possible that there could have been other purchases from the grey market, but there were no records. Mr Rashmi Chatwani's evidence was that the Appellants had traded in Gillette razor blades since 1983, when Davis & Dann was acquired. Mr Chatwani was unable to give an exact number of cases of Gillette razor blades which the Appellants had dealt in (from all

sources of supply) from 1983 to 2011 but estimated (rather vaguely) that the amount was "probably a few hundred thousand cases."

163. In addition, the Appellants provided evidence of their purchases of Gillette razor blades (of all kinds) from the grey market in the period 2007 – 2011. These razor blades were sourced from one of Procter & Gamble's authorised distributors based outside Europe. The Appellants started purchasing from this authorised distributor in 2007. The Appellants purchased: (in 2007) 7,819 cases worth $3,738,505.25, (in 2008) 6,526 cases worth $2,630,042.00, (in 2009) 7,859 cases worth $4,048,466.16, (in 2010) 20,864 cases worth $8,047,269.48 and (in 2011 to the date of the hearing) 6,596 cases worth $2,677,774.00. The total purchases of Gillette razor blades (of all varieties) in that 4–5 year period were, therefore, 49,664 cases worth $21,142,056.89. These razor blades were mainly sold to customers in the United States. Mr Rashmi Chatwani stated that the authorised distributor supplied Gillette razor blades to other customers and that his business was greater than the supplies made to the Appellants.

164. In a schedule exhibited to his witness statement, Mr Rashmi Chatwani compared the prices he paid for Gillette razor blades on the grey market with Gillette UK's list prices (converted to US dollars) for a three month period from 30 May 2007 to 27 August 2007. The schedule showed that the grey market purchase prices were at a significant discount to the Gillette UK list price. A summary of this schedule is attached as Appendix 2.

165. The authorised Gillette distributor, from whom the Appellants sourced their grey market purchases from 2007 onwards, had (in its forecast to Gillette) estimated more than it required in order to enable it to sell the excess on the grey market.

Market factors affecting M3 Power razor blades

166. Mr Rashmi Chatwani's evidence was that he had discussed M3 Power razor blades with the authorised distributor from whom the Appellants subsequently brought significant quantities of grey market Gillette products in 2007 – 2011. Mr Chatwani said:

> "Mr Rashmi Chatwani: It [i.e. Gillette business] was only discussed in the beginning of 2006 when I mentioned to him that we were going to get some large – a number of cases from a distributor here in England on the M3 Powers, and I just wanted to make sure that – but whether he was aware of anything, and he mentioned to me at that stage that there are goods which he will probably be able to get hold of because a lot of the distributors during that period will probably start selling the M3 Powers because –
>
> Mr Benson: Where is this in his statement?
>
> Mr Scorey: This is in chief. The statement is from December 2007.
>
> Mr Benson: Right.
>
> Mr Scorey: The Crown has had two goes at witness statements and there's been a complaint before about evidence in chief.

Mr Benson: Fine, you can go ahead.

Mr Scorey: I'm going to ask the witness in a moment why it's not in his statement and he can explain to the Tribunal why. If you could please carry on, Mr Chatwani.

Mr Chatwani: Yes, and at the time we had a general discussion about the M3 Powers and he confirmed to me that: yes, there could be a possibility that you might get – you're probably going to be able to get the goods as a lot of distributors were going to start selling those goods as Fusion [a new Gillette razor blade] was coming onto the scene.

At that stage I was not doing any Gillette business with him, because a lot of the goods which he had, I did not have a Gillette market for those goods at that time, because I could not bring those goods into Europe because of the trademark infringement. I cannot bring the goods from Far East into the European market because of strict trademark laws.

So we subsequently discussed about it, whether we could actually do some business, and I then created the market in the United States, and the goods were accepted by my US customers and we subsequently started dealing in 2007.

…..

Mr Scorey: Could you explain to the Tribunal why this evidence was not in your initial statement backing December 2007?

Mr Chatwani: Well, because anything I have discussed with my distributor, I've assured him that this is information which will be treated very confidentially. He asked me to assure him that even any of the goods which we buy from him at to be treated in the strictest of confidence. I had not filed any evidence apart from a schedule that we were selling some of the goods. We had never mentioned the territory. This is the first time in the last two weeks that we had decided to give evidence to Customs on the invoices, and therefore I decided this was the time to mention that."

167. Ms Jones was cross examined about the Worldwide Sales Schedule. Mr Scorey asked her to explain the fluctuation in sales over the year. He drew attention to the figures for North America which dipped from 5.7 million in January 2006 to 3.8 million in April. Ms Jones explained that this was because Gillette had launched Fusion in America in January 2006. She said that this would have "cannibalised" more from the M3 Power business than any other business because M3 Power was also a premium product. Mr Scorey asked:

"Mr Scorey: So, therefore, Fusion is launched and is competing head-to-head with M3 Power, if there are distributors or other traders holding large positions in the M3 Power, they will want to get shot them?

Ms Jones: We don't launch a product globally at the same time, so we launched in the US in January, we launched in the UK and, I believe, Germany I am not sure, in the September and the rest of the world is still following. There are many countries around the world that still don't have fusion today. So I don't see that would be a huge risk.

> Mr Scorey: But certainly it is a possibility?
>
> Ms Jones: For the big developed markets, yes, this is a product in decline.

168. Ms Jones accepted that her experience as an employee of Proctor & Gamble related to authorised channels of distribution. She accepted that she had no personal experience of grey market trading. Mr Jones's experience with limited mainly to the UK.

169. Our conclusion, in relation to Ms Jones's evidence, was that Ms Jones, whilst admitting that it was possible some distributors may wish to offload surplus stock of M3 Power razor blades, considered that the staggered launch of Fusion meant that this was not particularly likely (not a "huge risk"). We therefore did not consider it likely that the launch of Fusion explained the very large quantities of M3 Power razor blades that the Appellants were able to purchase.

Availability of information

170. Davis & Dann holds a direct account with Gillette and, indeed, had held such an account since before the company was acquired in 1983. A representative of the manufacturer would visit Davis & Dann on a regular basis to take orders. As noted, in the year to December 2005, Davis & Dann purchased in excess of £115,000 worth of goods from Gillette. In the nine months to September 2006 (before Gillette was taken over by Proctor & Gamble) Davis & Dann purchased over £70,000 worth of goods directly from Gillette.

171. Ms Jones's evidence was that information about market sizes and shares and about sales data would have been available in 2006 to a company which had an established relationship and an account manager with Gillette/Procter & Gamble. This was a daily occurrence. It was also her view that a trader dealing in the market of razor blades would "know roughly the kind of sizes and demand for the different M3 products."

172. The Appellants' evidence was that they were not surprised to be offered high volumes of Gillette products by Bristol. High volumes were characteristic of the grey market. It was Mr Tailor's understanding that razor blades accounted for between $3.5 to 4 billion of Proctor & Gamble's annual turnover.

173. Mr Tailor was asked about verifying quantities with the manufacturer:

> "Mr Scorey: You talk about the attitude of the manufacturers. It's been suggested that you should have contacted Proctor & Gamble directly to obtain some comfort about the volume of these goods or, alternatively, to ask whether they would match the price. What's your reaction to that?
>
> Mr Tailor: I think – well, you heard Victoria Jones say yesterday that they don't match the price, they won't match the price level; and I think number 2, if you are in the grey market, the minute you speak to a manufacturer saying: I've been offered some goods on the grey market;

> the first thing they're going to ask you is: where did you get them from and who is it part [sic] – they actually don't want the grey market on their doorstep. And I don't know of any general grey market trader who has ever phoned up a manufacturer to say: oh, can you help us,please, we're trying to buy your goods on the parallel market.
>
> I know that Victoria Jones said yesterday that she gets phone calls, but I believe that is in her trade sector. That is from the trade sector she deals with, i.e. multinational retailers and national retailers who have grey market divisions themselves. She's not wrong to say – I'm sure they have phoned her to say: we have been offered these goods; but that's not something that happens in the independent sector."

174. Mr Tailor also referred to the large shipment of approximately 170 containers of Huggies nappies (manufactured by Kimberly-Clark), referred to earlier, which had been purchased by the Appellants on the grey market and sold into the US market. The shipment had been intercepted by US Customs to verify the contents of the containers. The US Customs officials recognised that the Appellants would not wish them to speak to Kimberly-Clark because they knew that the products were being dealt with on the grey market.

175. Mr Rashmi Chatwani also gave evidence that it was an "unwritten rule" in the grey market that one did not discuss one's business with manufacturers.

176. Mr Tailor accepted in cross examination that he did not know and had not attempted to ascertain the size of the M3 Power razor blade market.

177. Mr Tailor explained that it was not unusual for the Appellants to undertake large deals with new players in the market with whom the Appellants had not traded before.

World Cup promotion of M3 Power razor blades

178. Ms Jones referred to a promotion organised by Procter & Gamble in respect of M3 Power razor blades in 2006. The promotion gave customers the chance to win tickets for the 2006 football World Cup. Miss Jones could not confirm the exact date on which promotional packs stopped being produced but did confirm that Proctor & Gamble tried to forecast appropriately to limit the number of "expired" packs in the distribution chain. If grey market traders held promotional packs which had passed the expiry date for the competition, it would not be possible for them to repackage the goods – this could only be done in-house by Proctor & Gamble for health and safety reasons.

179. Ms Jones was asked in cross-examination whether, if a trader had a large stock of special World Cup promotional packs and the World Cup was approaching, they may want to dispose of the promotional packs quickly. Ms Jones said that she had seen time expired packs, but Proctor & Gamble tried to forecast appropriately so this did not happen.

180. Mr Tailor's evidence was that when he inspected the first consignment of M3 Power razor blades at the warehouse of 1st Freight, he noticed that some of the boxes

containing packs of eight razor blades were World Cup promotional packs and some were not.

EAN codes and batch numbers

181. One of the most confusing parts of this appeal related to the assertions about EAN codes and batch numbers.

182. Mr Benson had initially argued that the alleged failure to record EAN codes represented a failure by the Appellants to exercise reasonable care to avoid being involved in carousel fraud (i.e. a version of MTIC fraud where the goods effectively go round in a circle and are used several times by MTIC traders). There was no allegation pleaded in these appeals that carousel fraud was present, although at times Mr Benson appeared to come close to making that allegation (or at least that the quantity of M3 Power razor blades in the disputed deals was so enormous that carousel fraud could be inferred).

183. As the hearing progressed, HMRC accepted that EAN codes were of no significance in this context. They were not like IMEI numbers, in relation to mobile telephones, unique reference numbers for each particular product. EAN codes were, in essence, bar codes which identified generic products and were the same whenever the product may have been manufactured. Thus, an EAN code would have been no assistance to the Appellants in determining whether the razor blades that they were acquiring were ones in which they had already dealt. Instead, the code was more likely to be relevant to Proctor & Gamble in recording electronic point of sales information.

184. In her evidence (in re-examination) Ms Jones suggested that each outer box of razor blades bore a unique batch number. She also stated that batch numbers were used for the benefit of Proctor & Gamble rather than for traders themselves.

185. The following day, in examination in chief, Mr Tailor produced various boxes of Gillette razors where the batch numbers were the same, although the time stamp was different. In other words, the batch numbers were not unique to each outer box, although the time stamp together with the batch number could, perhaps, be a unique number depending on quickly boxes were produced. There was no evidence that it was standard industry practice for traders to record batch numbers.

186. We did not consider that HMRC had established its case that batch numbers were unique reference numbers in the same way as IMEI numbers in the case of mobile telephones. In addition, it seemed to us that it would have been open to HMRC at any time before the hearing to have thoroughly investigated the issue of batch numbers. Its failure to do so and the ambiguities in the evidence arising in the course of the hearing seemed to us most unsatisfactory and was unfair to the Appellants. In the circumstances, we did not consider it fair or just that HMRC should be allowed to advance, "on the hoof" so to speak, a case based on batch numbers and we upheld Mr Scorey's objection to HMRC's belated and unpleaded attempt to allege that the Appellants should have recorded batch numbers.

GR Distributions and FAF International SRL

187. Once the Appellants had sold goods to CEMSA (a company based in Spain) the goods were, on CEMSA's instructions, in each case shipped to GR Distributions in France. GR Distributions were registered as "Wholesalers of wood, construction materials and sanitary equipment." CEMSA on sold the goods to an Italian company FAF International SRL but the goods remained physically in France.

Insurance

188. Initially, HMRC alleged that the Appellants did not have adequate insurance for the razor blades sold in the deals which are subject to this appeal. HMRC accepted at the hearing that this was incorrect and that the goods were insured.

Submissions

Submissions on behalf of HMRC

189. Mr Benson argued that the Appellants' requirement that Bristol give a Section 77A VAT Act 1994 declaration indicated that the Appellants suspected that their transactions were connected with fraud or suspected that the transactions might be connected with fraud. Mr Benson accepted that it was not sufficient to demonstrate that the transactions of the Appellants might be connected with fraud but submitted that a trader who was already on alert, not only of the fact that there is fraud present in its trade sector, but who also has a suspicion that its purchases may be connected with fraud should more readily conclude that the only reasonable explanation for the other circumstances of its transactions is that they are connected with fraud.

190. Mr Benson submitted that it was hardly surprising that the Appellants were suspicious of the purchases from Bristol for the following reasons.

191. First, the Gillette razor blade deals in May and June 2003, where Davis & Dann purchased from a UK supplier and sold on a back-to-back basis to a customer in another Member State, left Davis & Dann in an unusually large repayment position. Davis & Dann knew from the meeting of 10 June 2003 and the telephone call from HMRC on 11 June 2003 that those transactions had caused HMRC serious concern in the context of MTIC fraud.

192. Davis & Dann knew that the quantity and value of the transactions had caused HMRC concern. Davis & Dann also knew that the manner in which they had been approached (ie by an unsolicited customer and supplier wanting large quantities of the same product at the same time) was also considered indicative of MTIC trading. It was also noted that the goods had been traded through a third-party warehouse and were then shipped to Holland.

193. The Premium XXX card deals in July 2003 gave rise to a large repayment position and Davis & Dann was informed that these purchases were connected with fraud.

194. In the light of the above background a reasonable trader would have concluded from the factors known and the factors that could reasonably have been known that its purchases were, in fact, connected with the fraudulent evasion of VAT. These factors were as follows.

195. The Appellants' purchases put the Appellants in a significant repayment position. This was unusual for the Appellants. The last deals that had left the Appellants in such a position (the Premium XXX card deals) had been traced back to fraud.

196. The amount of razor blades purchased by the Appellants in the disputed deals was unreasonably large. M3 Power razor blade was a premium product. It had a small market share. The world sales figure for the product in April 2006 was 10.9 million razor blades. In the first two disputed deals (6 and 7 April 2006) the Appellants traded 576,000 blades or (5.2% of the world retail market or 15.1% of the Western Europe retail market). In the first four disputed deals (6, 7, 10 and 11 April 2006), the Appellants traded 1,536,000 razor blades (or 14.09% of the world market or 40.4% of the Western European market). In the first six disputed deals (6, 7, 10, 11 and 12 April 2006) the Appellant traded 2,976,000 blades (or 27.3% of the world market or 78.3% of the Western European market). In the first eight disputed deals (6, 7, 10, 11, 12, 18 and 19 April 2006), the Appellant traded 4,896,000 blades (or 44.9% of the world market or 128.8% of the Western European market). In the 20 disputed deals, the Appellants traded 23,184,000 blades or (212% of the world market).

197. The evidence of Ms Jones was that, as an account holder with Gillette/Proctor & Gamble, the Appellants would have been able to access this information. Ms Jones also considered that the dealer in the market of razor blades would know roughly the kind of sizes and demand for the different M3 products.

198. From the Appellants' own trading in the UK, they knew that demand for this product was small.

199. The disputed deals were of a much larger value than the deals usually undertaken by the Appellants. Subsequent purchases by the Appellants from an authorised dealer were of a much lower value spread over a long period of time. Also, these purchases were for a variety of different products including non-premium products.

200. The goods were traded in a third-party warehouse and were back-to-back sales that left the Appellants and a significant repayment position - similar to the deals in May, June and July 2003.

201. A reasonable trader would have ascertained that the EU third-party warehouse to which razor blades were delivered was not registered as a warehouse but as a "wholesaler of wood, construction materials and sanitary equipment." Also, a reasonable trader would have questioned why it was despatching goods to a warehouse in France when its customer (CEMSA) was based in Spain.

202. The Appellants' supplier, Bristol, was shown on the "Risk Disk" report as "non-trading." Furthermore Bristol described itself as a "composite drinks wholesale operation" that could offer a "wide choice of wines, spirits, beers, ciders and soft drinks." A reasonable trader, with a long history in trading in Gillette razor blades, would have questioned how a new business specialising in drinks was able to source such a very large quantity of razor blades at a price cheaper than the Appellants.

203. CEMSA was a company that traded in various goods including mobile telephones. A reasonable trader would have questioned why a company that traded in mobile telephones was able to buy a very large number of razor blades. This was particularly so given the credit report on CEMSA will which warned the Appellants to "tread carefully" and given that the facts known by the Appellants about CEMSA were not enough to allow them to offer credit and required CEMSA should pay for its goods prior to delivery.

204. Bristol's approach was "out of the blue" by fax on 11 January 2006 followed by a similar unsolicited approach from CEMSA on 27 January 2006, also by fax. Moreover, it was clear that the time between Bristol mentioning that it could source Gillette razor blades and CEMSA indicating it was interested in purchasing Gillette razor blades was a matter of a maximum of four days. A reasonable trader would have queried this coincidence.

205. Extremely favourable trading terms were offered to the Appellants i.e. the Appellants did not have to pay Bristol until payment was received from their customer. The Appellants should have questioned how a new business such as Bristol could offer credit to an established business such as the Appellants. The Appellants should have realised that Bristol, a newly constituted business, had either paid for the goods in full or had been able to obtain credit.

206. In the year ending 30 April 2006 total export sales were £29 million (£9.8 million in 2005). The disputed deals concluded in April 2006 (a three week period) constituted 40% of that total. Whilst on the date of the first deal, the Appellants may not have known how many further deals would be undertaken, it would quickly have been apparent that these deals were amounting to a significant and unusual quantity of their annual exports.

207. The above factors were ones that should have made it, in the words of Mr Young in the telephone call on 11 June 2003, "relatively straightforward for him to differentiate between that sort of trade [ie MTIC fraud related trade] and his normal day-to-day trade."

208. Mr Benson submitted that the correct approach was to look at all the characteristics of the deals *in toto* and not in isolation. If this approach was adopted a reasonable trader would have concluded that its purchases were connected with some form of fraudulent evasion of VAT. It might be possible to explain away or rationalise one or two of the circumstances present in the disputed deals but there were simply too many matters which were unusual or seemed amiss. On this basis the Appellants

should have realised that there was no other reasonable explanation for their transactions save that they were connected with the fraudulent evasion of VAT.

209. It was not necessary that the Appellants should have known that its transactions were connected with the fraudulent evasion by Leeming, in particular, or that they should have known of the details of the fraud. The test was whether the Appellants should, from all the circumstances, reasonably have concluded that their transactions were connected with the fraudulent evasion of VAT. The test in *Kittel* Case C – 439/04 should not be "over-refined". Moses LJ in *Mobilx* [2010] STC 1436 at 1453 said:

> "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."

210. Mr Benson argued that, notwithstanding this clear judicial guidance, the Appellants sought to persuade the Tribunal to look at each factor or characteristic related to the transactions in isolation. The *Kittel* test was whether the trader should have known, *from all the circumstances*, that its transactions were connected with fraud. Later in his *Mobilx* judgment Moses LJ said at page 1459:

> "But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. As I indicated in relation to the BSG appeal, tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud."

211. Mr Benson noted that Mr Scorey on behalf of the Appellants argued that HMRC had pleaded that it was Leeming that had evaded VAT and had not expressly pleaded fraud against others in the chain. He noted that the Appellants, in opening, put their case as follows:

> "… There is nothing wrong with the sale between Bristol Cash and Carry to us, nor us to CEMSA. They are not parties to the fraud."

212. Mr Benson submitted that it was a *non sequitur* to say that in the absence of an express pleading of fraud as against Bristol and/or CEMSA "there is nothing wrong with" the relevant sale. The Appellants were not entitled to ignore the objective circumstances in which its transactions took place. Mr Benson argued that, quite apart from the knowledge of Bristol and/or CEMSA, the characteristics of the transactions

were such that a reasonable trader in the position of the Appellants would have concluded that they were connected with fraud.

213. Mr Benson submitted that it was clear that the Appellants should, from all the circumstances, have known that its transactions in dispute were connected with the fraudulent evasion of VAT. Mr Benson asked that the appeals be dismissed and applied for costs.

Submissions on behalf of the Appellants

214. Mr Scorey submitted 67 pages of written closing submissions which were also summarised orally. It is not possible for us fully to summarise Mr Scorey's careful and detailed submissions, but the main points were as follows.

215. Mr Scorey noted that the only issue in dispute between the parties was whether the Appellants should have concluded that the only reasonable explanation for the transactions was that they were connected with fraud. He submitted that HMRC's evidence fell far short of demonstrating this. HMRC could not prove that a reasonable trader in the Appellants' position would have recognised that the deals in April and May 2006 were in fact connected to a fraud, particularly in circumstances where input tax incurred in respect of identical transactions in February and March 2006 had been repaid.

216. The Appellants were part of an established business that had been trading for some 30 years. The business involved exploiting opportunities in the legitimate grey market for FMCGs. Their success had been recognised by the award of the Queen's Award for Enterprise (Export) in 1997 and 2002. The Appellants' group were authorised distributors in other jurisdictions.

217. The Appellants purchased "hundreds of thousands" of cases of Gillette razor blades over the years, including over 20,000 cases in 2010 alone. Their experience of large volumes was not confined to razor blades. At one time, Davis & Dann also traded in a quantity of Huggies. In addition, Davis & Dann had also long been a serious player in the markets for Red Bull and Coca-Cola. Against that background, the deals in issue were entirely consistent with the Appellants' experience and understanding of the size of the Gillette market for razor blades.

218. Mr Storey submitted that HMRC had failed to identify the means by which the Appellants could and should have known about the pre-existing fraud in the supply chain. He submitted that nothing of which complaint was made would have alerted a reasonable trader in the position of the Appellants (and with the Appellants' experience) to the fact that these transactions were connected to a prior fraud. In short, HMRC's case lacked the essential ingredient of causation.

219. Mr Scorey noted that HMRC took until March 2007, with all the resources available to the State, to conclude that repayments should be disallowed. The test employed by HMRC at that stage was a lower evidential requirement than that

dictated by Moses LJ in *Mobilx* i.e. HMRC, at that stage, considered that the transactions "may" have formed part of an overall scheme to defraud the revenue.

220. We were invited by Mr Scorey to conclude that all the witnesses were credible and honest. Moreover, insofar as the evidence concerned the nature of the Appellants' business, trading history and the circumstances of the disputed deals, Mr Scorey submitted that the Appellants' evidence should carry more weight.

221. Mr Scorey relied on the decision of the High Court in *Locke v Stuart & Anor* [2011] EWHC 399 (QB) (a decision of Mr Andrew Edis QC sitting as a judge of the High Court) at paragraph 39:

> "Insurers making allegations of the kind which I have found proved in this case must do so with care. Their legal advisers have obligations which require them to advance such allegations only on proper grounds. I consider it to be inappropriate for trial bundles to contain the names and personal details of people with the suggestion that they have been guilty of fraud unless there are proper grounds evidentially for that assertion."

222. He submitted, therefore, that it was improper of HMRC to suggest fraud on the part of any party other than Leeming in the course of these proceedings.

223. Complaints about due diligence in respect of CEMSA were, in Mr Scorey's submission, irrelevant because no wrongdoing was alleged against CEMSA. Nothing done or undone in relation to CEMSA would have alerted the Appellants to the connection with fraud. Mr Scorey made the same submission in respect of 1st Freight, the freight forwarder.

224. Mr Scorey drew attention, in his submission, to the narrow ambit of the dispute between the parties. This was as follows:

(1) Leeming, the importer, fraudulently failed to account for output tax.

(2) No allegation of actual knowledge or complicity by the Appellants, Bristol, and CEMSA in respect of MTIC fraud had been advanced by HMRC.

(3) The M3 Power razor blades purchased by the Appellants did in fact exist, notwithstanding the fact that they were purchased in high volumes and constituted a large market share (by reference to the retail market, but not by reference to the grey market).

(4) There was no allegation that the goods had been "carouselled" or were part of a contrived deal chain.

(5) The goods were traded at normal grey market prices, which, of course, were below the white market list price. There was no suggestion that the price must have been artificially depressed by reason of fraud or prior evasion of VAT.

225. The correct legal test in the light of *Mobilx* was not whether traders, such as the Appellants, exercised reasonable due diligence but whether they should have known that the transaction was in fact connected to a fraudulent evasion of VAT. A helpful

way of establishing this, to which Moses LJ repeatedly referred on behalf of a unanimous Court of Appeal, was to ask whether the only reasonable explanation for the circumstances in which the transaction took place was that it was connected to the fraudulent evasion of VAT. It was not enough for HMRC to demonstrate that a trader should have known that its transactions were more likely than not to be connected with fraud.

226. Mr Scorey noted the Tribunal decision in *Network Euro v HMRC* [2011] UK FTT 255 (TC). Mr Scorey agreed with HMRC's submission that *Mobilx* did not limit them to showing means of knowledge by reference to what was the only reasonable explanation for the transaction. But if HMRC did not show that the only reasonable explanation for the transaction was that it was connected to fraud, then in some other way they needed to establish that the Appellants should have known that the transaction was connected with fraud. Mr Scorey noted that HMRC adopted the "only reasonable explanation" test in their skeleton argument and submitted that it was a useful standard by which to judge HMRC's case.

227. Mr Scorey submitted that HMRC had to identify some aspect of the transaction that called for an explanation i.e. the circumstances had to be such that the taxpayer should make enquiries as to whether those circumstances arose from a fraudulent evasion of tax. Mr Storey submitted that HMRC had failed to identify any circumstance which demanded an explanation because of an antecedent fraud.

228. The burden of proof lay upon HMRC. Moses LJ in *Mobilx* held as follows at paragraph 81:

> "HMRC raised in writing the question as to where the burden of proof lies. It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion. No sensible argument was advanced to the contrary."

229. Mr Scorey submitted that the logical corollary was that to the extent any aspect of HMRC's case (a) had not either been sufficiently pleaded or particularised or (b) deviated from their pleaded case as amended, it was consistent with the principle of fundamental fairness that HMRC be precluded from running such an unpleaded or unparticularised case.

230. Mr Scorey further noted HMRC's reliance on the dicta of Moses LJ at paragraphs 82 – 83 of *Mobilx*, where he emphasised that undue focus should not be placed on the question of due diligence but rather Tribunal's should consider "attendant circumstances in context" and the "totality of the deals affected by the taxpayer." He submitted that by directing attention to the "bigger picture", HMRC sought to divert the Tribunal's attention from the lack of causation demonstrated by HMRC in their evidence.

231. Mr Scorey noted that, in contrast to other MTIC appeals, in which HMRC have produced evidence on the grey market for the goods in question, in this appeal HMRC had only brought forward evidence as to the authorised or white market distribution in

the UK. Ms Jones, an executive of Proctor & Gamble, had given evidence regarding her lack of expertise in the grey market. She also accepted that her white market knowledge was limited to the UK. She also confirmed that Proctor & Gamble was opposed to grey market trading by confirming that they preferred to reduce the amount of grey market material so that Proctor & Gamble could sell as much as possible at their list price. Mr Scorey therefore submitted that Ms Jones's evidence was of limited assistance. Ms Jones had no knowledge of, or way of finding out about, cross-border grey market activity that did not result in UK supermarket tills sales.

232. Mr Scorey submitted that the failure of HMRC to reduce relevant evidence as to the grey market for Gillette goods contrasted with the compelling evidence given by the Appellants, based on their substantial trading history in grey market commodities over many years.

233. The Appellants had traded in substantial quantities of Coca-Cola, Red Bull and Kimberly-Clark Huggies nappies. The Appellants had traded in razor blades since 1983 since which time they had traded in hundreds of thousands of cases. They had purchased significant volumes from both Gillette directly and in the grey market.

234. The Appellants had continued to trade in large quantities of Gillette razor blades in the grey market since the disputed transactions. Mr Rashmi Chatwani explained that such a grey market source was not uncommon in his experience.

235. Grey market trading by the Appellants was opportunistic and this, therefore, resulted in fluctuating turnover from year to year.

236. A proportion of the M3 Power razor blades were promotional packs which provided an opportunity to win tickets for the 2006 World Cup. As was apparent from the sample of the actual products purchased, the promotion expired on 15 April 2006 (the World Cup occurred in June July 2006), which might explain their presence on the grey market.

237. Mr Scorey submitted that in order to find that the Appellants should have known that the only reasonable explanation for its transactions was that they were connected with fraud, the Tribunal had to be satisfied that:

(1) The Appellants had the means, at the time of entering into the transactions, of discovering that the transactions were connected to the specific tax losses attributable to fraud earlier in the supply chains.

(2) The Appellants were culpable or at fault and failing to discover the fraud despite having the means to do so. When assessing the means available to the Appellants, the analysis must take into account the subjective characteristics of the Appellants, including the resources available to them. The concepts of reasonableness and proportionality had to be taken into account.

238. Mr Scorey characterised HMRC's case as an invitation to the Tribunal to infer from the evidence that the Appellants should have known telepathically that the transactions were connected to an unspecified, unnamed and unknown VAT fraud. Mr Scorey submitted that the surrounding circumstances did not hint at any possible

fraud, nor did the nature of the individual transactions betray any suspicion of a connection to fraud. The transactions entered into by the Appellants were themselves bona fide and materially identical to previous transactions which, he submitted, were untainted by fraud in February and March 2006.

239. Thus, Mr Scorey's primary submission was that HMRC could not prove their case and that, therefore, the appeals must be allowed.

240. Alternatively, the Appellants advanced a positive case that they should not – indeed could not – have known about any connection with Leeming's fraud. The Appellants took reasonable and proportionate steps to guard against becoming an unwitting participant in MTIC fraud. Objectively, there was no reason to suspect that the transactions were connected with fraud.

241. It was important to bear in mind, Mr Scorey submitted, that:

(1) the only allegation of fraud was directed at Leeming.

(2) No allegation of fraud or wrongdoing was alleged against the Appellants.

(3) It was not alleged that the Appellants had any dealings with Leeming.

(4) It was not alleged that any member of the supply chain (including Bristol and CEMSA) were party to the fraud perpetrated by Leeming.

(5) It was not alleged that any party "manoeuvred" the Appellants into purchasing the goods.

(6) No allegations could be made that the Appellants' transactions were other than genuine commercial purchases from, and sales to, legitimate counter-parties.

242. Mr Scorey submitted that HMRC could not advance a logical case on causation in relation to CEMSA (or their third-party distributor, GR Distribution).

243. Mr Scorey also submitted that the issue (of what the Appellants should have known) had to be assessed at the time of entry by the Appellants into the transactions in dispute. Hindsight could not be used.

244. In relation to pleaded allegations made by HMRC, Mr Scorey accepted that the Appellants as experienced and responsible traders were generally aware of MTIC fraud but took steps to avoid it. They also appreciated that MTIC fraud could affect FMCGs

245. Ms Okolo had accepted that HMRC had not notified the Appellants that the Gillette razor blade deals in May and June 2003 had been traced back to a fraudulent tax loss.

246. As regards Bristol, no allegation of fraud was made by HMRC. Mr Tailor's evidence was that Bristol operated a well-resourced cash and carry business dealing in a range of items. The Appellants' evidence was that it was not unusual to be approached by new suppliers. CEMSA did not make contact until several weeks later – not "in quick succession" as alleged by HMRC. The Appellants carried out due

diligence on Bristol. Mr Tailor considered that his first-hand knowledge was more current than the generic "Risk Disk" data. He took the reasonable view that where a company was listed as dormant, it could recommence trading at any time.

247. Mr Tailor visited Bristol's premises to verify that the business was legitimate, even though the Appellants were not offering credit. He inspected stock, concluded that it existed and was genuine. He took photographs of the stock. None of this evidence was challenged. He observed significant trading activity notwithstanding that Bristol was a newly formed company. Mr Scorey noted, on the other hand, that Ms Okolo had never visited Bristol's premises. He invited the Tribunal to conclude that Mr Tailor's first-hand knowledge carried greater weight than Ms Okolo's perusal of an out of date company report.

248. The fact that Bristol was substantially a drinks cash and carry was not of concern to the Appellants. This was not surprising, given that Davis & Dann, conversely, specialised in toiletries but had a large volume of grey market trading in soft drinks.

249. As regards the suggestion that the credit terms offered by Bristol called for an explanation, the Appellants' evidence was that they did not consider it unusual that Bristol might be able to fund 18 of the 20 deals in which credit was provided.

250. In respect of CEMSA, the Appellants spoke with the principal by telephone, verified its VAT registration number, visited its premises in Spain and obtained the necessary company documents (which were translated by Mr Rashmi Chatwani's secretary, a native Spanish speaker).

251. As regards the allegation that it was unusual that CEMSA contacted the Appellants and enquired about the availability of razor blades, Mr Rashmi Chatwani's evidence was that there was nothing odd about this. Moreover, the Appellants did not offer credit to CEMSA and the financing figures contained in the Dunn & Bradstreet report obtained in February 2006 were not particularly relevant. Mr Chatwani also made it clear that the goods had been offered, not just to CEMSA, but also to other potential buyers.

252. Although not pleaded, HMRC had criticised the back-to-back nature of the trades. The Appellants' evidence was that back-to-back trading was a normal feature of their business. As Mr Tailor explained, "we were not going to buy the goods if we couldn't sell them." This, in Mr Scorey's submission, was commercial common sense.

253. In relation to the fact that the goods were stored at a third-party warehouse (1st Freight), the Appellants had given reasonable explanations as to why the goods were kept at the warehouse. They had satisfied themselves as the security of the warehouse and did not wish to incur the extra risk and expense of moving the goods.

254. As regards the arguments of HMRC in respect of the quantity of M3 Power razor blades that the Appellants were able to source from Bristol, Mr Scorey submitted that the goods in question existed and were the subject of a bona fide sale by Bristol to the Appellants, followed by a bona fide sale to CEMSA. High-volume was a normal feature of grey market trades.

255. Mr Scorey criticised HMRC's evidence in relation to worldwide sales provided by Proctor & Gamble and exhibited to Ms Okolo's witness statement. The document, he said, was obtained from the UK arm of Proctor & Gamble, rather than from any expert grey market source. HMRC did not call the maker of the table to give evidence to explain its significance. The Appellants also noted some minor mathematical errors. Mr Scorey noted that the evidence appeared to be developed by reference to point of sale data for large retailers, rather than by reference to production figures. It was, therefore, a snapshot of monthly sales figures and did not take into account the stock that might be held up in the supply chain.

256. Furthermore, Mr Scorey submitted that the table had only been produced following protracted correspondence between HMRC and Proctor & Gamble. It was not available to the Appellants. Mr Tailor's evidence was that the Appellants regularly dealt in large volumes of Gillette products. He also confirmed that the Appellants had previously bought large quantities of product from suppliers with whom they had never traded before and were new to the marketplace.

257. In relation to the argument put forward by HMRC that the Appellants should have known that the quantities exceeded the likely demand for the M3 Power razor blades, there was no evidence to support this assertion.

258. Mr Scorey described HMRC's case regarding favourable trading terms as an invention of the Commissioners. In addition, there was no antecedent evidence of standard or usual trading terms. In any event, the Appellants confirmed that, by reason of the established nature of their business reputation, they typically benefited from credit terms.

259. In conclusion, in relation to HMRC's pleaded case, Mr Scorey asked:

(1) what could/should the Appellants have done differently?

(2) What would additional/alternative actions have revealed?

(3) Why would such additional/alternative steps have caused the Appellants to realise that the only reasonable explanation for the transactions was fraud?

(4) How were HMRC’s allegations sustainable when all the "indices" of fraud which HMRC pointed could just as easily be characterised as the usual incidences of international trade?

260. Mr Scorey submitted that in relation to the "only reasonable explanation" test, the Appellants had met each of the criticisms advance by HMRC with a reasonable explanation. Those explanations lost nothing when considered cumulatively.

261. Mr Scorey criticised the reasons for the denial of input tax given in the decision letters written by Ms Okolo. It was wrong to suggest that the Appellants had received a letter advising them of a hijacked VAT number in relation to the Gillette deals in May/June 2003. In evidence, Ms Okolo accepted that this did not occur. In relation to the CEMSA company documents, Ms Okolo did not enquire whether the Appellants were capable of translating the documents (which they did through Mr Chatwani's secretary). The allegation of lack of formal terms and conditions was erroneous. The

Appellants used formal terms and conditions. The allegation in respect of lack of insurance was conceded by Ms Okolo to be a mistake.

262. It was clear from the evidence, that the tax loss issue was resolved by 3 September 2006, when HMRC sent a letter to the Appellants confirming the existence of a fraudulent tax loss attributable to Leeming. Mr Scorey submitted that, at that stage, HMRC were able to form a view of the Appellants' means of knowledge at the time of the transactions. However, they did not do so for another six months.

263. Mr Scorey noted that HMRC had argued that any doubts on the issue of quantity of razor blades could have been resolved by telephone call to Gillette. Mr Scorey submitted that the Appellants had no such "doubt", as they were used to dealing in very high quantities of products. In any event, Mr Rashmi Chatwani had made independent enquiries regarding the products coming onto the grey market with his business contact (the authorised distributor from whom he subsequently made grey market purchases of Gillette products in 2007 and subsequent years). His contact explained that distributors were likely to start selling M3 Powers as the new "Fusion" product was coming onto the market. This was a perfectly rational explanation, which was not challenged in cross examination. Ms Jones had also confirmed that the new "Fusion" product was likely to "cannibalise" the M3 Power market share, which she said was a possible reason why distributors were offloading M3 Power stock onto the grey market.

264. Mr Tailor's evidence had been that it was impractical for grey market traders to verify quantities with Proctor & Gamble. Ms Jones dealt with multinational retailers and national retailers who had grey market divisions themselves. He was not aware of any grey market trader who had ever phoned up a manufacturer to ask for help in relation to purchasing goods on the grey market. Mr Rashmi Chatwani also gave evidence that Proctor & Gamble would not have assisted with such a query.

265. Therefore, in Mr Scorey's submission, any telephone call to Proctor & Gamble requesting verification of market shares and sizes would have been redundant.

266. As regards the fact that the transactions in dispute left the Appellants in a large repayment position – which had previously attracted scrutiny from HMRC – Mr Scorey noted that most of the Appellants' onward sales were exports and therefore did not attract output tax. It was perfectly legitimate for the Appellants to incur input tax and seek a refund on their purchases. The fact that large repayments were previously scrutinised by HMRC could not be relevant, particularly when the Appellants had not been notified that these purchases had been connected to a tax loss.

267. For these reasons, Mr Scorey invited the Tribunal to allow the Appellants' appeals and asked for their costs.

Our decision

268. In our view, the Appellants should have known that the transactions in dispute were connected with fraudulent evasion of VAT.

269. In reaching this conclusion we are mindful of the test laid down by the unanimous Court of Appeal in the *Mobilx* i.e. that HMRC must prove its case and that it is not enough for HMRC to establish merely that the taxpayer should have been aware that its transactions *might* have been connected to fraudulent evasion. Instead, it was necessary for HMRC to prove that the taxpayer's transactions *were* connected to fraudulent evasion. The issue had to be determined in the light of the circumstances of which the Appellants were aware or should have been aware at the time the disputed transactions were entered into. It was common ground that the standard of proof was the normal civil standard, viz the balance of probabilities.

270. In our view, the correct test is simply whether the Appellants should have known that its transactions were connected to the fraudulent evasion of VAT. It is not necessary for HMRC to prove that the Appellants should have known the details of the specific fraud or that they should have known that the fraud was carried out by Leeming.

271. We have applied the test repeatedly set out by Moses LJ in *Mobilx* and summarised by Lewison J in *Brayfal* and which was referred to in the hearing before us as the "only reasonable explanation" test. As already noted in this decision, Lewison J said:

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

272. In our view, all the circumstances must be considered when applying the *Kittel* test, as formulated by the Court of Appeal in *Mobilx*. As Christopher Clarke J said, in his much quoted passage (approved by Moses LJ in *Mobilx*) in *Red 12 Trading Limited v HMRC* [2009] EWHC 2563 (Ch) at paragraphs 109 – 111:

> "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.

> 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.
>
> 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."

273. The "only reasonable explanation" test must be, in our view, applied to the totality of the evidence. It is not enough to demonstrate that each characteristic or circumstance, relied on by HMRC to show that the Appellants should have known that the disputed deals were connected to fraud, when viewed in isolation, may have a reasonable explanation. Instead, all the circumstances in which the transactions took place must be considered and the test - the “only reasonable explanation test” - must then be applied in the light of all those circumstances. If it were otherwise, and it was possible to give a potentially reasonable explanation for each allegedly suspicious circumstance viewed in isolation, it would then not be possible to consider the cumulative improbability of all those circumstances combining in relation to the disputed transactions.

274. Moreover, we accepted Mr Benson's submission that the fact that HMRC only alleged fraud in respect of Leeming did not entitle the Appellants to disregard the totality of the circumstances, viewed objectively, in which their transactions took place.

275. Finally, in considering the factual context and circumstances in which the disputed transactions took place, it was necessary to ask, not just (as Mr Scorey put it) what more the Appellants could have done, but it was also necessary to ask what conclusions the Appellants should have drawn from the facts either already known to them or of which they ought to have been aware.

276. We should point out that our conclusions are based on the evidence considered as a whole. Some factors were, in our view, more compelling than others. Some aspects of the evidence were not conclusive by themselves but when viewed in the context of the evidence of the whole, supported our conclusion that the Appellants should have known that their transactions were connected with fraud.

277. We have reached our decision for the following reasons.

278. It was not disputed that the Appellants were aware of MTIC fraud. In May and June 2003 the Appellants had undertaken razor blade deals which had quite plainly caused HMRC considerable concern. The Appellants were aware that MTIC fraud could be conducted through the medium of razor blade deals. They realised that MTIC fraud was not simply confined to the common varieties of goods such as mobile telephones and computer components. Indeed, they were aware that in July 2003 they had unwittingly become involved in transactions in Platinum XXX cards where the deal chains traced back to fraudulent evasion of VAT.

279. For the reasons given earlier in this decision, we are satisfied that the Appellants were warned by Mr Young on 11 June 2006 of certain characteristics (" quantity, value, the manner of approach by supplier and customer etc") of MTIC transactions which should have helped them identify transactions of which they needed to be wary.

280. The razor blade deals in May and June 2003, left Davis & Dann in an unusually large repayment position. That position was not replicated, for the Appellants, until they undertook the M3 Power razor blade deals in February, March, April and May 2006. The repayment position in April and May was far greater than it had been in any previous period. (See paragraph 85) This, of itself, should have alerted the Appellants that their deals were unusual or, at least, having unusual results which were similar (but even larger in terms of VAT repayments) to those in respect of deals of which they had been warned in 2003 (albeit that they were not told that those deals had actually been traced back to fraudulent evasion).

281. The Appellants failed to read the warning signals in respect of Bristol. First, Bristol was primarily a company trading in drinks. We accept that wholesalers can deal in goods which are different from their main lines of business. Indeed, the Appellants dealt in soft drinks in the grey market even though their main business concerned FMCGs, such as toiletries. Nonetheless, this fact had to be viewed in the light of the other circumstances concerning Bristol and should, in those circumstances, have given rise to concerns.

282. Secondly, Bristol was not an authorised Gillette distributor. The evidence was that a number of other very large purchases of (non-razor blade) products had been made by the Appellants in the grey market, but the Appellants had bought from authorised distributors. Again, we do not say that buying from a non-authorised distributor is an inevitable indication that a purchase was connected to fraud, but it is a factor which must be taken into account along with all the other circumstances.

283. Thirdly, according to the Risk Disk report, Bristol had only been trading for a maximum period of less than 12 months. Nonetheless, this fledgeling business was able to supply huge quantities of premium Gillette razor blades, products which were outside its main line of business, to a customer (the Appellants) who had traded in Gillette products for many years on both the grey and white markets. Mr Tailor, although aware that Bristol could not have been in business for more than 12 months,

admitted that he had failed to ask Mr Singh how long Bristol had been trading. This seemed to us, in the circumstances, a notable omission.

284. Fourthly, Bristol made an unsolicited approach to the Appellants. It was not until some time after 23 January 2006 that discussions between Bristol and the Appellants concerned Gillette razor blades. The evidence was that until that date discussions had concerned drinks, or at least had not concerned razor blades. Four days later, on 27 January 2006, CEMSA made an unsolicited approach to the Appellants. These were the type of circumstances of which the Appellants had been warned by Mr Young in 2003.

285. In this context, we accept the Appellants' evidence that they regularly received unsolicited approaches. However, the circumstances surrounding these unsolicited approaches – e.g. the coincidence of timing, the readiness to sell and buy huge quantities of a particular product and the absence of an antecedent trading relationship – should have made the Appellants suspicious. It seems to us that, because the Appellants regularly received unsolicited approaches from trading partners, to say that this constituted a reasonable alternative explanation (as regards the "only reasonable explanation" test) plainly demonstrates the fallacy that undermines Mr Scorey's argument: viz that each suspicious circumstance, viewed in isolation, could be explained away on an innocuous basis. The fact that the Appellants received numerous unsolicited approaches from potential customers and suppliers does not mean that they should not have been alerted to the existence of fraud by unsolicited approaches where the surrounding circumstances meant that they should have had their suspicions aroused.

286. Finally, in relation to the warning signals about Bristol, the Appellants received credit from Bristol in very considerable amounts. No questions appear to have been asked by the Appellants as to how Bristol was either able to fund the provision of credit or had itself obtained goods on credit. Again, buying goods on credit does not of itself point inevitably to the fact that such a transaction is connected to VAT fraud; indeed buying goods on credit will often be a perfectly normal commercial transaction. Buying goods on credit, where the amount of the credit is very substantial indeed, from a business which has only been in operation for less than 12 months, where the credit is extended in respect of goods outside the supplier's normal line of business, from a supplier who has made an unsolicited approach to the Appellants and who had commenced discussions about razor blades days before an unsolicited buyer contacts the Appellants indicating an interest in razor blades, is a rather different proposition.

287. As we have said, the quantity of M3 Power razor blades dealt in by the Appellants was the subject of considerable debate during the hearing. What was not in dispute was the very large value of razor blades bought and sold by the Appellants in the disputed deals. The evidence was that in no other two month period in their trading history did the Appellants buy razor blades of any description amounting to £24,860,766 or indeed anywhere near that value. Certainly, the Appellants never bought razor blades (of one particular type) of that value. The value of the deals – we shall discuss the quantity below – made these deals exceptional. We accept that the

Appellants also bought very valuable consignments of other products on the grey market (e.g. Huggies nappies, a deal which was described as being for many millions of dollars, Red Bull and Coca-Cola), but these were purchases of products from authorised distributors of the manufacturer.

288. Between 2007 – 2011, the Appellants bought large quantities of Gillette razor blades and other Proctor & Gamble products on the grey market from an authorised distributor outside Europe. The maximum value of these deals in any one year (2010) was $8,047,269.48. The deals were spread out over an entire year. It will be seen that the value, even in respect of a whole year, fell far short of the value of the Appellants' purchases of them M3 Power razor blades in April and May 2006.

289. As regards the quantity of M3 Power razor blades dealt in by the Appellants in the deals in dispute, only in 2010 did the Appellants deal in a greater number of cases (20,864 cases). The Appellants dealt in 14,449 cases of razorblades in the deals in dispute. But the cases purchased by the Appellants in 2010 were acquired during the course of 12 months and covered a variety of different Gillette razor blades which were of a lower value. As noted above, the value of the razor blade purchases in 2010 was $8,047,269.48. In the period 1983 – 2011 Mr Rashmi Chatwani's evidence concerning the number of razor blades ("probably a few hundred thousand cases") bought by the Appellants was vague. Certainly, the value of razor blades bought directly from Gillette in the period 1998 – 2006 was relatively modest, with a maximum value of £1,987,592.47 in 2000 (because of the special deal offered by Gillette). We accept that the Appellants bought large numbers of Gillette razor blades over the years, but we do not accept that they bought such a large number and value of a particular type of razor blade in such a short period of time as in the disputed deals in April and May 2006. The quantity and value of these deals made them most unusual and, in our view, extraordinary.

290. We accept the evidence of Ms Okolo, which was based on information supplied by Proctor & Gamble, concerning the worldwide and regional sales of M3 Power razor blades. The evidence was that in April 2006 (the first 17 deals) the Appellants bought and sold 17.376 million M3 Power razor blades compared with total global sales of M3 Power razor blades of 10.9 million and 4.8million for Western Europe i.e. 159% of the total global sales and 362% of sales for Western Europe. In April and May 2006 the Appellants bought and sold over 100% (approximately 105%) of the total worldwide sales of M3 Power razor blades, bearing in mind that the Appellants undertook transactions on only three days in May 2006 (to the value of £5.808 million).

291. By any measure, the Appellants purchased a huge quantity and value of razor blades in a very short period of time. They were experienced dealers in Gillette razor blades. They knew from Mr Young's comments in the 11 June 2003 telephone conversation that quantity was one of the factors of which they needed to be aware in relation to MTIC fraud. The scale of these purchases was such that the Appellants should have been on notice that these transactions were exceptionally odd. This is so regardless of the availability of the information in the Worldwide Schedule. The

Appellants should have been aware that these circumstances called for extreme caution.

292. We do not accept that the quantity of M3 Power razor blades purchased by the Appellants in the disputed deals could be explained by the possibility that the goods were a special promotion in relation to the World Cup. Mr Tailor's evidence was that only a part of the sample that he retained related to the World Cup promotion. Ms Jones's evidence was that Proctor & Gamble tried to forecast appropriately so that the number of time-expired promotional packs in the distribution chain was limited. In our view, it was more likely than not that the volume of M3 Power razor blades acquired by the Appellants in the disputed deals could not be explained by the approaching expiry of the World Cup promotion.

293. Similarly, we do not consider that the quantity of goods in the disputed deals can be explained by the introduction by Gillette of the Fusion razor blade. Ms Jones accepted that in developed markets the introduction of the Fusion model meant that the M3 Power razor blade was "a product in decline". Although recognising it as a possibility, she did not consider that there was "a huge risk" that dealers would want to offload large quantities of M3 Power blades, because the introduction of Fusion was staggered across jurisdictions. Certainly, we did not consider the introduction of Fusion to be the reason why the Appellants were able to buy such enormous quantities of M3 Power blades.

294. Finally, we consider that the Appellants should have been put on notice that the fact that GR Distributions was registered as "Wholesalers of wood, construction materials and sanitary equipment." On its face, the business of GR Distributions seem to have nothing in common with the products being dealt in and surely called for some explanation or enquiry.

295. For these reasons, notwithstanding the skilful arguments of Mr Scorey, we have concluded that the Appellants should have known that the disputed transactions were connected with the fraudulent evasion of VAT. We dismiss these appeals.

296. The Tribunal has already directed that Rule 29 Value Added Tax Tribunals Rules 1986 shall apply to these appeals and HMRC have applied for costs if the appeals are dismissed. Accordingly, we direct that the Appellants pay the reasonable costs of HMRC, the amount to be assessed by a costs judge, if not agreed.

297. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

GUY BRANNAN

TRIBUNAL JUDGE
RELEASE DATE: 17 January 2012