[2012] UKFTT 229 (TC)

TC01923

Appeal number: LON/2008/1823
LON/2008/1824

VAT – input tax – missing trader intra-community (MTIC) fraud – whether the Appellant knew or should have known that his transactions in question were connected to fraudulent evasion of VAT

FIRST-TIER TRIBUNAL
TAX CHAMBER

DARREN RICHARD LEITCH **Appellant**
(trading as LONDON MOBILE COMMUNICATIONS)

- and -

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

TRIBUNAL: JUDGE ROGER BERNER
TYM MARSH (Member)

Sitting in public at The Victoria House, Bloomsbury Place, London WC1 on 27 June – 3 August 2011 and at 45 Bedford Square, London WC1 on 9 December 2011

Gareth Rees QC and Samantha Riggs, instructed by Aegis Tax LLP, for the Appellant

Michael Vere Hodge QC, Craig Ludlow, George Rowell and Oliver Powell, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The Appellant, Darren Leitch, trading as London Mobile Communications ("LMC"), appeals against a decision of HMRC, in their letter of 31 July 2008, to deny LMC input tax credit in respect of value added tax of £20,512,931.96 in respect of VAT periods 02/06, 03/06, 04/06, 05/06 and 06/06 (that is the monthly accounting periods from February 2006 to June 2006). Mr Leitch also appeals against a notice of assessment issued on the same date which was raised in respect of £5,939,353 of the amount of input tax credit denied, and which had already been repaid to Mr Leitch.

2. The grounds for the decision and the assessment were that the transactions relating to Mr Leitch's claims for input tax credit were connected with the fraudulent evasion of VAT through what is known as missing trader intra-community (or MTIC) fraud, and that this was something Mr Leitch knew or should have known.

MTIC fraud

3. In a basic MTIC fraud a "missing" or defaulting trader imports goods from another EU member state. That acquisition does not give rise to any liability to VAT, either in the UK or in the other member state. That trader sells the goods to a UK trader (referred to in the common terminology as a "buffer"). The missing trader charges VAT on that sale, but does not account for it to HMRC. The goods can then be sold through a series of buffer traders. In each case VAT is charged, but except for what is usually a small mark-up this VAT is largely offset by the input tax credits that the buffers have on their own purchases of the goods.

4. A trader acquiring the goods from a buffer will at some point export the goods to another member state or outside the EU. This exporting trader is referred to as the "broker". Exports are zero-rated, so the broker is not liable to account for VAT, but claims from HMRC a refund of the VAT it has paid on its own purchase of the goods from the buffer. It can be seen that if HMRC make a repayment, the loss of VAT caused by the default of the missing trader becomes crystallised.

5. A more elaborate MTIC scheme, known as "contra-trading", was devised by the perpetrators of the fraud in order, it appears, to disguise the overall fraudulent purpose. This involves not one but two (or more) chains, one of which (the "dirty" chain) contains the missing trader and the other of which (the "clean" chain) contains the broker. The two chains are linked so that the missing trader's debt is offset against the input tax repayment.

6. The link is made through a "contra-trader" who features in both chains. In the dirty chain the contra-trader is an exporter, thereby generating a right to repayment of input tax. In the clean chain the contra-trader is the importer, who then sells the goods to the broker or (more likely) to a buffer trader from where through a series of transactions the broker exports those goods and makes the claim for input tax

repayment. The important feature of contra-trading is that the right to repayment arises in a different chain from that of the default. The contra-trader, although being part of the dirty chain, makes no effective repayment claim, as its right to repayment is offset by the VAT on its sale in the clean chain. The repayment claim has effectively been shifted to the broker in the clean chain.

7. We describe MTIC fraud in this way by way of background. There is no dispute in this case that Mr Leitch's transactions that are the subject of HMRC's decision and assessment were connected to fraudulent evasion of VAT. It is not accepted by Mr Leitch that there was a single conspiracy. The dispute between the parties centres on whether Mr Leitch knew or should have known that his transactions were connected to fraud in the deal chains in question. That is a question that clearly has to be answered by reference to the facts and circumstances existing at the time of those transactions and not with the benefit of hindsight.

The law

8. There was no dispute on the applicable law. The dispute centred on the application of the law to the particular facts of this case, which we shall examine in some detail. The following is therefore a summary only of the legal principles that fall to be applied.

9. The denial of a right to deduct input tax in the circumstances that HMRC allege to be present in this case derives from what is known as the Kittel principle. That principle was set out in the leading Court of Justice ("ECJ") case of *Axel Kittel v Belgium; Belgium v Recolta Recycling* [2006] ECR 1-6161; [2008] STC 1537. *Kittel* was concerned with the application of the Sixth Council Directive (77/388/EEC of 17 May 1977) concerning the treatment of VAT in Member States and, specifically, the right to deduct VAT payments from VAT liability. The ruling of the ECJ was that:

> "… where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct."

10. On this basis it is common ground that the questions for the Tribunal are:

(1) Were the transactions in issue connected with fraudulent evasion of VAT?

(2) If so, did Mr Leitch know, or should he have known, that the said transactions were connected with such fraud?

11. Mr Leitch conceded the first of these questions. Accordingly we are only concerned with the question of what Mr Leitch knew or should have known.

12. For a number of reasons it is important to note that in respect of the transactions that are the subject of this appeal Mr Leitch is a sole trader; the supplies giving rise to the claim for repayment of input tax were not made by a limited company. It is true, as we shall describe, that Mr Leitch also carried on business through a limited

company, London Mobile Communications Limited ("LMC Ltd"), and that company was involved, as supplier of the relevant goods to LMC, in the deal chains, but it is his role as a sole trader that forms the context of these appeals.

13. This is, in our view, significant in determining the person or persons whose knowledge or means of knowledge must be determined. Were these appeals to have been made by a limited company, which cannot have any knowledge or means of knowledge in its own right, the question would arise as to what extent the knowledge of directors or employees of the company could be imputed to the company itself: see, for a recent example, *Revenue and Customs Commissioners v Greener Solutions Limited* [2012] UKUT 18 (TCC). Where the appellant is a sole trader, the ordinary rules of agency apply. In this case, as we shall describe, Matthew Sheridan, who worked for LMC on a self-employed basis, had authority to conclude, and did conclude, transactions on behalf of Mr Leitch. Only in certain cases, those involving traders with whom LMC had not previously dealt, particularly large deals or if credit was sought, did Mr Sheridan refer the transaction to Mr Leitch for approval. We are satisfied, therefore, that Mr Sheridan's knowledge and actions in relation to LMC may be attributed to Mr Leitch. That was the submission put for HMRC, and it was not disputed.

14. The Kittel principle has been considered by the Court of Appeal in *Mobilx (in Administration) and others v Revenue and Customs Commissioners* [2010] EWCA Civ 517, [2010] STC 1436. In giving the leading judgment of the court, Moses LJ made it plain that *Kittel* represented a development of the law because it enlarged the category of those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants, and that once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct (see [41]). He continued (at [42]):

> "By the concluding words of para 59 the court must be taken to mean that even where the transaction in question would otherwise meet the objective criteria which the court identified, it will not do so in a case where a person is to be regarded, by reason of his state of knowledge, as a participant."

15. It is thus not only those who evade VAT, such as the missing traders themselves, who do not have the right to deduct. The scope of the right to deduct also excludes a taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT. This is because such a person is to be regarded as a participant and accordingly fails to meet the objective criteria.

16. We are here concerned with whether Mr Leitch knew or should have known that his transactions were connected with VAT fraud. The means of knowledge element of this concept was defined in *Mobilx* by Moses LJ not in terms of negligence but by reference to the objective criteria for the test (at [52]):

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

17. By way of further explanation Moses LJ rejected HMRC's argument that it is sufficient to show that the trader should have known that he was running a risk that his purchase was connected with fraud; such a test would infringe the principle of legal certainty. It must be established that the trader knew or should have known that by his purchase he was taking part in a transaction connected with the fraudulent evasion of VAT. He said (at [59] -[60]):

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

18. After confirming that the burden of proof lies on HMRC to prove that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct, Moses LJ went on to make it plain that the surrounding circumstances can establish sufficient knowledge to treat the trader as a participant. In particular he warned against an undue focus on due diligence (a subject we shall return to later). He said (at [82]):

> "… 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 focussing 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."

19. In his judgment, Moses LJ cited with approval the approach of *Christopher Clark J in Red 12 Ltd v Revenue and Customs Commissioners* [2009] EWHC 2563, [2010] STC 589, quoting paras [109] to [111] of that judgment:

> "[109] Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature eg that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and 'similar fact' evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.
>
> [110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> [111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

20. Mr Rees and Ms Riggs, in their closing submissions, drew our attention to what Lewison J said in *Revenue and Customs Commissioners v Livewire Telecom Ltd* [2009] EWHC 15 (Ch), [2009] STC 643 (at [87] and [88]), where he rejected the suggestion that if a taxable person failed to take every precaution that could reasonably be expected, he would automatically be deemed to be a participant in fraud and would forfeit his right to deduct input tax. Even if such a person has not taken every precaution that could reasonably be expected of him, he will still not forfeit his right to deduct input tax in a case where he would not have discovered the connection with fraud even if he had taken those precautions.

21. In our view, to focus on matters such as the taking of reasonable precautions is to fall into the trap, identified by Moses LJ in *Mobilx*, over seeking to over-refine the test in *Kittel*, and to place too great an emphasis on due diligence or the absence or inadequacy of it. That is part of the picture, of course, but is only one of the circumstances to which Christopher Clark J in *Red 12*, and Moses LJ in *Mobilx*, have referred. The question is whether the only reasonable explanation for the circumstances in which the transactions take place is that the transactions have been, or will be, connected to fraud.

The evidence

22. We had a number of witness statements on behalf of HMRC. Of principal relevance was that of Barry Patterson, a VAT assurance officer who specialises in assurance visits to traders suspected of being involved in or affected by MTIC fraud, and who conducted such visits on Mr Leitch's business in the relevant period. Mr Patterson was cross-examined by Mr Rees for Mr Leitch. We also had witness statements from Roderick Stone, an HMRC officer with extensive experience of dealing with MTIC fraud and other forms of VAT fraud and associated money laundering, Andrew Simms, a senior compliance accountant with HMRC, Debbie Loftus, an investigation officer for HMRC, Judith Clifford, a higher officer of HMRC, Andrew Kirkby, an HMRC officer, and Jennifer Davis, an HMRC officer. None of those statements was challenged. Mr John Fletcher, a principal adviser in KPMG LLP, provided a witness statement in the form of an expert report on the mobile handset market, and was cross-examined. We also had further witness statements from HMRC officers concerning the defaulters in the deal chains in question and the contra-traders. These statements were not disputed.

23. For Mr Leitch, we had witness statements from, firstly, Mr Leitch himself, and from Matthew Sheridan who as a self-employed trader worked for Mr Leitch, and who was also an employee of London Mobile Communications Limited ("LMC Ltd"). Both were cross-examined by Mr Vere-Hodge for HMRC. We received a witness statement from Mr Nigel Attenborough, a director of NERA Economic Consulting, in the form of a report entitled "Is there Scope for a Legitimate Grey Market for Mobile Handsets in the UK?" Mr Attenborough was also cross examined.

24. In addition we were provided with a considerable number of binders containing voluminous documentation. Additional documentation was also admitted by us in the course of the hearing.

The facts

25. From all this evidence and from the documents we have been referred to we find the following facts.

The LMC business - background

26. Mr Leitch is an enterprising businessman. He set up his first business at about the age of 18 when he pooled his savings with his sister, Vicky, and set up a balloon

company. They had their own premises and would manufacture, customise and deliver balloons for event and functions. According to Mr Leitch's evidence, this business was quite successful, but it closed in about 1994, when both Mr Leitch and his sister decided to move on to different things.

27. Mr Leitch then bought his first phone shop, in Dagenham. The former business had been run under the name of Online Communications, which Mr Leitch changed to the present business of LMC, operating as a sole trader. Business was confined to the retail shop, and the turnover was not sufficient to require VAT registration.

28. In about 1996 to 1997 Mr Leitch began to venture into the wholesale trade in mobile phones, buying from official distributors whilst continuing to source stock through his existing supplier network. He would buy stock in large quantities from DVH, an authorised distributor, and sell on to smaller companies. Buying in larger quantities enabled him to achieve greater discounts, and consequently increase his own profit margin. By mid-2000 this trade was quite substantial. In his witness statement Mr Leitch recalls that in this period the company one2one (which became T-Mobile) approached DVH with an offer of 70,000 units of phones returned by a customer under a 14-day grace period. Mr Leitch took the whole deal from DVH and sold both wholesale and retail through his shop. This was confirmed by evidence of a VAT visit by a VAT officer, Sharon Leigh.

29. LMC was registered for VAT with effect from 24 March 1997.

30. Following on from these wholesale ventures, Mr Leitch decided to move into "box-breaking". As described by Mr Leitch, his box breaking business involved engaging people to buy pre-paid phones from various retail outlets. These phones were collected together and then sold by Mr Leitch in bulk to traders who were exporting from the UK, in order to take advantage of the lower retail price in the UK. He would often informally pool his resources with those of other traders in order to put together sufficiently large packages of phones to be of interest to the exporters. This method of trading is confirmed by the evidence of Mr Fletcher to be part of the legitimate grey market in mobile phones.

31. Mr Leitch first met Matthew Sheridan as one of the "shoppers" for mobile phones for export in the box breaking venture. After closing his Dagenham shop, Mr Leitch began to work with Mr Sheridan in an informal partnership. A friend of Mr Sheridan was experiencing difficulties with another shop, and Mr Leitch took this over, running the business as a combined retail and wholesale operation, with an emphasis on box breaking. Although the main focus was not on exports, when they could afford to Mr Leitch and Mr Sheridan would "cut out the middleman" and sell the phones they had collected from box breaking to overseas customers, strengthening their overseas contacts.

32. In 2003 the shop business was closed, and Mr Leitch and Mr Sheridan commenced operating a purely wholesale business from converted barn premises in Pilgrim's Hatch, Brentwood.

33. According to Mr Sheridan's evidence, early export deals were unsuccessful, and so Mr Leitch stopped them and moved to UK to UK dealing. Mr Sheridan described the method of trading as having stock allocations assigned to LMC for later purchase and ordering and holding onto stock. The aim, in relation to certain models, was to dominate the supply and so influence the price. The traditional method of sourcing stock to meet specific demand proved unsatisfactory. LMC turned to buying stock in bulk, or seeking an allocation (without purchase). Mr Sheridan said that at times LMC had almost all the phones of a certain model on the market, and that when the price was right those phones would be sold, either as a whole or in separate lots. It did not matter what the model was, as long as a decent mark-up could be obtained.

34. The business became busier after it had joined the International Phone Traders (IPT) website in 2003. This was a site that enabled buyers and sellers of mobile phones to advertise their stock or requirements. It effectively opened the market from one that depended on contacts within the industry to one where buyers could be matched with sellers for particular phones, in particular quantities through information contained on the website. This was effectively the trigger for LMC to move into the export market. The IPT website saved LMC from having to make what Mr Sheridan described as "thousands of phone calls", and opened new doors for the business. LMC began approaching the export market once more, and to deal more closely with traders who were themselves exporting. Mr Sheridan described the summer before the launch of LMC Ltd as the busiest of times for LMC.

35. LMC Ltd was incorporated on 19 September 2003. For a period after its incorporation up to 2005 it was effectively dormant. However, before long, as a reward for his success in the business and as a future incentive, Mr Leitch offered Mr Sheridan a stake in the company. Mr Sheridan eventually became the owner of a 50% shareholding in LMC Ltd. The activities of LMC Ltd began in January 2005, when the company employed Mr Sheridan to run the trade floor. After a year of trading through LMC Ltd, Mr Leitch and Mr Sheridan found new premises in Billericay, Essex. The business (both of LMC and LMC Ltd) had moved from box breaking to include some bulk purchases from other UK companies. Although the business contacted official distributors from time to time, those distributors generally only offered pre-paid stock, which was of no interest.

36. Mr Sheridan's evidence was that LMC Ltd hit the ground running, and the business continued its upward trend. Contacts with traders and suppliers were carried across from LMC. The administrative work increased and other staff were employed to filter out the offers and applications so that Mr Sheridan could consider the deals that were more likely to be worth doing.

37. Mr Leitch explained, and we find, that he tried in 2005 to undertake exports using LMC Ltd, rather than doing the deals himself as a sole trader. However, HMRC would not permit the company to move from quarterly to monthly returns. On the other hand, LMC itself was on monthly returns. Mr Leitch appreciated that in those circumstances it would make sense to move the majority of the export business to LMC. This would enable the capital tied up in the VAT that had to be paid to the supplier to be recovered more quickly. Because of the cash flow implications, it

would have been feasible for LMC Ltd only to have exported at the end of each VAT quarterly period (which would minimise the delay before a return was made with the VAT repayment claim). Using LMC, on the other hand, meant that transactions could be effected and VAT reclaimed on a monthly basis, thus enhancing the cash flow, and allowing export transactions to be undertaken during a three-month period, instead of just at the end of it.

Combating MTIC fraud

38. It is convenient at this stage to summarise the steps that were being taken by HMRC (at that time HM Customs & Excise) to combat MTIC fraud, at the time LMC's trade was developing.

39. HMRC (at that time HM Customs & Excise) introduced its strategy for tackling MTIC fraud in September 2000. This included a previous strategy of removing the VAT registrations of missing traders from the VAT register at the earliest opportunity in order to protect future revenue.

40. From October 2001 HMRC established a system to enable traders in Southern England in the trade sectors commonly associated with MTIC fraud to enquire of the MTIC validation team at Redhill, Surrey as to the validity of the VAT registration details of their potential customers and suppliers. By August 2003 this had been extended to all parts of the UK.

41. In June 2002 HMRC decided to conduct a programme of extended verifications to establish whether supply chains commenced with a deliberate tax loss and were circular in nature such as to constitute an MTIC carousel fraud. The first business selected for this extended verification was Bond House Systems Limited, followed by a further 50 businesses believed to be broker traders whose transactions displayed the characteristics seen by HMRC as associated with MTIC fraud.

42. The methodology of extended verification involved verifying transaction chains and tracing them back to missing traders and forward to the overseas customers and beyond. Where it could be established that a chain commenced with a deliberate tax loss and was circular in nature, the repayment claim submitted by the broker was disallowed. The legal basis for the disallowance was that the transactions were not genuine economic activity and therefore, so the argument went, fell outside the scope of the VAT system.

43. This legal basis was challenged in the ECJ by Bond House and two other companies, Optigen Limited and Fulcrum Electronics Limited. In January 2006 the ECJ rejected the "no genuine economic activity" argument, and held that a taxable person who did not know and had no means of knowing that his purchase was

connected with VAT fraud had the right to deduct the input tax incurred on that purchase[1].

44. In the meantime the UK had taken steps to introduce a measure (now contained in s 77A of the Value Added Tax Act 1994) to enable joint and several liability to be imposed where a taxable supply of specified goods (originally restricted to telephones and computers and their parts and accessories) had been made to a taxable person, and at the time of the supply the taxable person knew or had reasonable grounds to suspect that some or all of the VAT payable in respect of that supply, or on any previous or subsequent supply of those goods would go unpaid.

45. The joint and several liability provisions came into effect on 10 April 2003. However they were challenged by a trade association, the Federation of Technological Industries. Until the judgment of the ECJ rejecting that challenge on 11 May 2006[2], the joint and several liability provisions were not enforced. Nevertheless, HMRC published its policy in respect of those provisions in Notice 726, first issued in August 2003.

46. Notice 726 addressed, in the context of the joint and several liability provisions, the reasonable steps a trader might take to protect himself from involvement in VAT fraud. Paragraph 4.5, dealing with what might constitute "reasonable steps" acknowledges that a trader is not necessarily expected to know his supplier's supplier or the full range of selling prices throughout the supply chain. It goes on to say: "However, we would expect you to make a judgement on the integrity of your supply chain." Paragraph 8 provided:

> "8. **Dealing with other businesses – How to ensure the integrity of your supply chain**
>
> 8.1 **Checks you can undertake to help ensure the integrity of your supply chain**
>
> The following are examples of checks you make wish to undertake to help establish the integrity of your supply chain.
>
> 1) Undertaking reasonable commercial checks to consider the legitimacy of customers or suppliers. For example:
>
> - What is the supplier's history in the trade?
> - Are normal commercial arrangements in place for the financing of the goods?
> - Are the goods adequately insured?
> - What recourse is there if the goods are not as described?

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1 See joined cases C-354/03, C-355/03 and C-484/03: *Optigen Ltd v Customs & Excise Commissioners*; *Fulcrum Electronics Ltd v Customs & Excise Commissioners*; *Bond House Systems Ltd v Customs & Excise Commissioners* [2006] STC 419 (ECJ).

2 See Case C-384/04: *Customs & Excise Commissioners v Federation of Technological Industries and others* [2006] STC 1483 (ECJ).

2) Undertaking reasonable checks to ensure the commercial viability of the transaction. For example:

● Is there a market for this type of goods – such as superseded or outdated mobile phone models?

● Is it commercially viable for the price of the goods to increase within the short duration of the supply chain?

● Have normal commercial practices been adopted in negotiating prices?

● Is there a commercial reason for any third party payments?

3) Undertaking reasonable checks to ensure the goods will be as described by your supplier. For example:

● Do the goods exist?

● Have they been previously supplied to you?

● Are they in good condition and not damaged?

We recommend that sufficient checks be carried out in each of the above categories to ensure that you are not caught in a fraudulent supply chain.

8.2 **Checks carried out by existing businesses**

The following are examples of specific checks carried out by existing businesses. These may also help you to decide what checks you should carry out, but this list is not exhaustive and you should decide what checks you need to carry out before dealing with a supplier or customer:

● obtain copies of Certificates of Incorporation and VAT registration certificates;

● verify VAT registration details with Customs and Excise;

● obtain letters of introduction on headed paper;

● obtain some form of trade reference, either written or verbal;

● obtain credit checks or other background checks from an independent third party;

● insist on personal contract with a senior officer of the prospective supplier; making an initial visit to their premises whenever possible;

● obtain the prospective supplier's bank details, to check whether:

(a) payments would be made to a third party; and

(b) that in the case of import, the supplier and their bank shared the same country of residence.

● Check details provided against other sources, eg website, letterheads, BT landline records.

Paperwork in addition to invoices may be received in relation to the supplies you purchase and sell. We believe that this documentation should be kept as evidence of a transaction's legitimacy. The following are examples of additional paperwork that some businesses retain:

- purchase orders;
- pro-forma invoices;
- delivery notes;
- CMRs (Convention Merchandises Routiers) or airway bills;
- allocation notification;
- inspection reports.

Again this is not an exhaustive list, but does show some of the more common subsidiary documentation."

47. In January 2006 the government announced that they intended to introduce a reverse charge to VAT on mobile phones and computer chips. The reverse charge in fact took effect from 1 June 2007. It applies to mobile phones and computer chips which are valued at £5,000 and over and which are made by one taxable person to another. Under the reverse charge mechanism it is the purchaser of the goods, rather than the seller, who is liable to account for the VAT on the supply. The supplier will not charge VAT, but must specify on the invoice that the reverse charge applies. The purchaser must account for VAT, but has the right to input tax recovery on the same VAT return, subject to the normal conditions. This makes it impossible to commit MTIC fraud in the relevant goods. Each participant in the supply chain has to pay VAT straight to HMRC rather than passing it down the chain. There is thus no opportunity for a missing trader to disappear with the VAT paid to him by his supplier but owed to HMRC; no opportunity for buffer traders to divert VAT from their suppliers through third party payments; and no opportunity for a broker to claim a VAT repayment from HMRC.

Visits etc by HMRC

48. Since the VAT registration of Mr Leitch, trading as LMC, in March 1997, and up to the beginning of the period at issue in these appeals, the business, along with LMC Ltd, received numerous visits from VAT officers, and much correspondence passed between the business and HMRC. Examples include:

(1) On 20 June 2002 an MTIC warning letter was sent by HMRC advising of fraud within the industry and instructing LMC to keep evidence of removal of goods to countries within the EC.

(2) On 24 October 2002 HMRC sent Mr Leitch a letter informing him of eight of his suppliers that had been deregistered for VAT or which had hijacked other taxable persons' VAT numbers, warning about making third party payments and requesting the monthly submission of sales and purchase listings.

(3) On 27 March 2003, Mr Patterson carried out a VAT audit at LMC's premises. At this time he was informed that LMC was moving back into the export market, specifically Dubai and Hong Kong. LMC requested to go onto monthly returns, which was agreed.

(4) On 28 July 2003 the Redhill VAT Office sent LMC a standard form letter warning of the risks of MTIC fraud, and advising Mr Leitch to verify the details of actual and potential customers with that office.

(5) On 14 April 2004 adjustments were made disallowing input tax credits in the sums of £75,950 (09/03) and £195,020.88 (10/03) in relation to three purchases made from a UK company, Phone Direct Limited, and related sales made by LMC to a company in Spain. The grounds for disallowance were that the purchases and sales formed part of chains of supply that were circular in nature and contained a defaulting trader, and the supplies were not part of any economic activity.

(6) As a result of this on 26 April 2004 Mr Leitch asked Mr Patterson for details of the traders in the deal chains, information that Mr Patterson was unable to provide for data protection reasons. Mr Leitch informed Mr Patterson at a visit on 6 May 2012 that he was being sued by Phones Direct Limited in relation to monies owed by LMC.

(7) On 10 June 2004 Mr Patterson visited Mr Leitch. During the meeting MTIC and carousel trading was discussed. Mr Leitch informed Mr Patterson of an intention to export goods to Dubai.

(8) At a visit on 6 July 2004, it was reported that LMC was holding some stock at this time, whereas previously all deals had been of a "back to back" nature, with no stock being retained.

(9) On 3 December 2004 HMRC sent Mr Leitch a letter disallowing input tax credit of £32,375 in respect of the 07/04 period, again on the ground that the supplies were not part of an economic activity. The supplier in respect of the goods in question was Highfield Distribution (UK) Limited, trading as Celex UK. During Mr Patterson's next visit to LMC on 16 December 2004, Mr Leitch had telephone conversations with Mr Kam Kumar, the director of Celex, in respect of the assessment, from which Mr Patterson understood that Mr Leitch was refusing to pay Celex certain monies. Mr Leitch was under the impression that Celex had made third party payments in connection with the supply. We accept that Mr Patterson had not described Celex as "dodgy" or that he had said that Celex were responsible for making the third party payments. He had simply said that there were third party payments in the chain of transactions.

(10) By the visit of 18 January 2005, from which time all visits were on LMC and LMC Ltd jointly, although LMC Ltd had completed only four deals, the business of LMC had increased significantly.

(11) At the visit on 22 July 2005 Mr Leitch made it clear to Mr Patterson that, since the monthly return request in respect of LMC Ltd had been refused, LMC would continue to trade and would be the "export" registration (receiving monthly repayments) while LMC Ltd would concentrate on the UK market.

(12) On 25 February 2005 a letter was sent from HMRC to Mr Leitch adjusting the VAT return for period 12/04 by £11,930.72 on account of discrepancies between LMC's commercial documentation and the amounts declared on the VAT return for that period.

(13) Mr Patterson visited the two businesses on 18 May 2005. During this visit Mr Patterson completed HMRC's MTIC aide memoire directly onto his laptop. This involved Mr Leitch answering questions relevant to the trading of both businesses. With regard to due diligence, Mr Leitch stated that all trade references obtained were verbal, no credit or Companies House checks were undertaken. The only checks being done were the basic VRN verification at Redhill. No separate insurance was taken out; the goods were said to be insured by the freight forwarders.

(14) On the same day Mr Patterson handed Mr Sheridan a copy of Notice 700/52 (notice of requirement to give security to HM Customs & Excise), Notice 726 and Business Brief BB 15/03 dated 12 August 2003 (VAT strategy: Input tax deduction without a valid VAT invoice: Statement of Practice).

(15) On 12 August 2005 Mr Patterson visited LMC. He reported that the business was looking at new premises in the Basildon area, not far from its present location. A new bank account had been opened with the First Curacao International Bank ("FCIB") in the Netherlands Antilles (though the existing Bank of Scotland account was also to be maintained).

(16) On 2 September 2005 and 6 September 2005 letters were sent to Mr Leitch advising of potential notices of assessment in respect of stock differences. These consisted of purchase invoices with no apparent onward sale, sales invoices with no apparent purchase invoice and other minor differences. The periods in question ran from June 2004 to July 2005.

(17) At a visit on 19 September 2005 Mr Patterson was informed that new premises had been obtained and it was hoped to move in shortly. There was a discussion about stock held by both LMC and LMC Ltd. Subsequently, at a further visit on 29 September 2005 Mr Leitch agreed that he would try and confirm stock levels held for both LMC and LMC Ltd when he met with Hawks (the freight forwarder) in the following week.

(18) When Mr Patterson visited on 8 November 2005, he was informed by Mr Leitch that the *Bond House* decision (of the ECJ) was due on 7 December 2005. Mr Leitch was also at this time aware that other traders were subject to verification of transactions concerning supplies to Dubai.

(19) Following *Bond House*, HMRC wrote to Mr Leitch advising him that manual payments would be made pending the outcome of his appeal to the VAT Tribunal concerning periods 09/03 and 10/03.

(20) On 10 January 2006 Mr Patterson visited and was informed that no deals had been done by LMC since his previous visit on 11 November 2005. Mr Leitch was still looking for premises in the Romford area.

49. That summarises some of the visits and communication between HMRC and LMC up to February 2006, the start of the period in which the transactions that are the subject of these appeals took place. Up to that date there were also a number of assessments and letters of adjustments issues over the years. Errors in general accounting and bookkeeping amounting to £516,141.06 had been made.

50. During the same period leading up to February 2006, LMC and LMC Ltd together received veto letters in respect of 22 traders. Certain letters advised LMC and LMC Ltd of deregistrations of traders with whom they had been dealing, and warned of possible verification of input tax claimed for transactions purporting to take place after the effective date of cancellation. Over the entire period, joint and several warning letters were sent on 10 occasions, there were 34 veto letters and five general warnings about MTIC fraud, as well as the two assessments on the grounds of non-economic activity. In February 2006 HMRC informed LMC that 204 of its purchases between August and December 2005 had been traced to traders who had defaulted on VAT liabilities totalling £10.6 million.

The deal chains

51. The denial of input tax relates to the transactions of LMC associated with 121 supply chains. The evidence of those chains, which was not disputed, shows that 113 of the chains led directly to 31 traders who, between them, had fraudulently defaulted on £19,139, 079 of input tax in relation to those chains. The remaining 8 chains led to two contra traders, Future Communications (UK) Limited and Wetherby Fashions Limited.

52. We had documentation, both in the form of deal chain schedules and the underlying documentation, for each of the deal chains. However, Mr Patterson also provided evidence of possible alternative deal chains in 25 cases where in relation to the deal chains for LMC more than one transaction in the same quantity of identical goods, on the same date, had been identified at some point in the chain. In those cases, therefore, it had not been possible for HMRC to confirm the correct invoicing chain with absolute certainty.

53. Nonetheless, in respect of all 25 of the deals in question HMRC have traced every UK line of supply identified and have found that all such lines of supply originated in a fraudulent tax loss. In 20 of the deals, despite the several different companies appearing in the lines of supply, the same defaulter has been identified at the point of acquisition of the goods into the UK.

54. In the following analysis of the deal chains we have taken account of the alternative deal chains and have noted relevant points accordingly.

55. A particular feature of LMC's transactions in the relevant period is that its supplier was, in all cases, LMC Ltd. LMC Ltd itself issued a total of 926 sales invoices between February and July 2006, 123 of which related to the transactions by LMC that are the subject of these appeals. Of the remainder, 49 of the invoices were missing from the records provided to HMRC and are stated by Mr Leitch to relate to cancelled transactions, and 724 related to sales made by LMC Ltd as a buffer trader, either to broker traders other that LMC or to other buffer traders. The remaining 30 invoices were for sales to EC customers, in respect of which input tax recovery was denied to LMC Ltd.

56. As regards cancelled transactions, we were shown two examples of invoices marked “Cancelled” by Mr Sheridan. These were in respect of sales of 4,500 and 4,400 Nokia 9300i phones to World Communications France SARL on 8 and 9 June 2006 respectively. Mr Sheridan explained that deals could be cancelled in many circumstances. These included: if the specification was not what the customer wanted; if LMC decided to sell elsewhere; if the stock was “pulled” by a supplier; or simply the customer did not want the stock. Mr Sheridan said that this happened quite a lot.

57. It does not appear, however, that any of these reasons could have applied in the case of the two invoices produced. Whilst those invoices, numbered 64 and 69, were cancelled, the deals themselves were in fact done. Deal 111 (invoice 70) was for 4,500 Nokia 9300i phones, at the same price (£322.50 per unit) as the cancelled invoice 64, and deal 112 (invoice 71) was for 4,400 of the same phones again at the same price as the cancelled invoice 69. This is therefore an example of a cancellation of the paper invoices, rather than the cancellation of deals. Some therefore of the missing invoices, we conclude, though we cannot say how many, are attributable to this type of cancellation, and not to cancelled deals.

58. The only other evidence of a cancelled deal was in relation to a trade with Optime Strategies Ltd, where we saw correspondence, to which we also refer to later, showing that LMC Ltd suffered loss on a deal in 2005 resulting from a cancelled deal. The circumstances of that cancellation were that Optime, a UK company that was the exporter in that case, cancelled its trade with LMC Ltd because its own trade with a company in the Netherlands, Brightrade BV, was cancelled. Although unrelated to the cancellation, the transaction reveals a failure, on the part of the inspection company, Hawks Precision Logistics Ltd, to identify 12 missing items in the consignment. A fax from Hawk to Mr Sheridan, on 13 October 2005 identifies certain discrepancies on two consignments and refers to allocations of stock “down the chain to London mobile”.

59. The evidence thus shows that, excluding the 49 missing invoices, HMRC have traced the vast majority of the supply chains to defaulting or contra traders. None of LMC’s or LMC Ltd’s 926 invoices have been traced to a legitimate source, whereas 98% by value of the invoices (ignoring the missing invoices) were connected to VAT fraud.

60. With some variations in particular cases the deal chains ending in an export sale by LMC follow a recognisable pattern. We set out below one example. In this example, we examine the way in which, if the “profit” from the fraud is an amount equivalent to the VAT that has not been paid over by the defaulting trader, the amounts of profit mark-up for each of the traders in the chain can be analysed as a percentage of that overall “profit”.

LMC (broker)	mark-up of £6.50 x 1,700 units:	£11,050 = 17.1% of profit
LMC Ltd (buffer)	mark-up of £0.50 x 1,700	£850.00

	units: Less net VAT paid to HMRC: Net share of profit:	(£148.75) £701.25 = 1.1% of profit
T M Global Ltd (buffer)	mark-up of £0.50 x 1,700 units: Less net VAT paid to HMRC: Net share of profit:	£850.00 (£148.75) £701.25 = 1.1% of profit
Oakleaze Ltd (buffer)	mark-up of £1.50 x 1,700 units: Less net VAT paid to HMRC: Net share of profit:	£2,300.00 (£446.25) £1,853 = 2.9% of profit
Direct Billing Ltd (buffer)	mark-up of £0.50 x 1,700 units: Less net VAT paid to HMRC: Net share of profit:	£850.00 (£148.75) £701.25 = 1.1% of profit
A K Global Ltd (buffer)	mark-up of £0.40 x 1,700 units: Less net VAT paid to HMRC: Net share of profit:	£680.00 (£119.00) £561.00 = 0.9% of profit
K and S Communications Ltd (missing trader)	mark-up of £0.75 x 1,700 units	£1,275.00 = 2.0% of profit

61. The amount of VAT evaded by the missing trader in this example was £64,587.25. Third party payments were made to a non-UK company, Sunico A/S, with the result that £64,500 of the VAT evaded by the missing trader was received outside the UK.

62. In the chains at issue in this appeal, LMC applied larger margins than any of the buffer or defaulting or contra traders, and larger margins than LMC Ltd (which in all cases acted as a buffer supplying to LMC). LMC's own margins ranged from £3.50

to £43.00 per unit, with most being in the range between £5.00 and £11.00. The other participants applied fixed mark-ups ranging from £0.50 to £2.00.

63. On its sales to LMC, LMC Ltd applied a similar mark-up (50p, £1 or £1.50, irrespective of value, quantity or model of the mobile phone in question) to those of other buffer traders in the chain. Mr Leitch sought to explain this by saying that it reflected the need to operate LMC Ltd commercially, and to reward staff working for the company, who were on commission and who could otherwise have sold to a third party UK company. We do not accept that explanation. It does not explain why these uniform mark-ups were adopted. It also ignores the fact that LMC could readily have compensated the employees without imposing that particular mark-up. We find that these mark-ups merely reflected what LMC Ltd knew was the standard practice for buffer traders.

64. On the other hand, we reject the submission on behalf of HMRC that the purpose of the mark-up was to increase the amount of VAT that LMC would pay to LMC Ltd, and so somehow inflate the amount of reclaimed VAT. The amount of reclaimed VAT would increase (compared to the position if LMC Ltd had not been inserted into the chain), but only by the same amount as the VAT payable by LMC Ltd on its own supply to LMC. There would be no net increase in VAT recoverable from HMRC, so far as the LMC businesses were concerned.

65. Although LMC Ltd had been set up to take over the business of LMC, this strategy was abandoned because HMRC refused to allow LMC Ltd to move from the standard quarterly to monthly returns. This meant that if LMC Ltd were to conduct export business it would either suffer a cash flow disadvantage in not being able to obtain repayment until the end of the quarter in question, or else would have been confined to undertaking such transactions only at the end of each quarter. The decision was therefore taken to continue conducting the export transactions through LMC, namely by Mr Leitch as the sole trader, in spite of the risks that would be run by a business with unlimited liability.

66. That does not explain, however, why LMC Ltd was retained as a buffer trader in all the deals undertaken by LMC in the relevant period. Mr Leitch said that he wanted the business, expanding as it was, to be a limited company, as that would be more professional. By January 2006 the business in LMC Ltd was increasing and that in LMC was slowing down. But the VAT position resulted in a change of plan. Notwithstanding this, Mr Leitch said that because traders had done due diligence on the limited company, the decision was taken to retain it.

67. We find this explanation unconvincing, especially since, as was put to Mr Leitch in cross-examination, the effect, through LMC Ltd adding its own mark up, was to increase the cash flow cost to LMC in recovering its own input tax. It would also have had the effect, according to the understanding of Mr Leitch and Mr Sheridan, of increasing the overall business' potential liability under the joint and several liability provisions. It would have been evident to traders that the established trader was LMC, and that LMC and LMC Ltd were effectively one business. The due diligence done by suppliers on LMC Ltd would not have been any obstacle to those

suppliers once again trading with LMC. In fact, in his evidence, Mr Leitch also made the point that traders would have disregarded the fact the LMC Ltd had only a short trading history, and would have understood that they were really dealing with Mr Leitch. We consider that the use of LMC Ltd was an attempt by the business to obtain the benefit of limited liability on its own trades with suppliers. That would have isolated Mr Leitch from liability on those trades themselves. However, in the event, limited liability did not prevent Mr Leitch himself incurring liability to LMC Ltd for amounts of credit aggregated at some £8.3 million at the time of the liquidation of LMC Ltd.

Deal chain analysis

68. An examination of the deal chains, arranged chronologically, reveals a number of patterns. One of those patterns is the congruity of trades involving particular missing traders. In any particular period transactions tend to emanate from one, or only a few, missing traders. The following table illustrates the position with a number of examples:

Deal number	*Missing trader*
1 - 3	Rayzah Ltd
4 - 6	K & S Communications Ltd
7 – 10, 16	RR Investments Ltd
17 - 21	Netforce Technologies Ltd
24 -26	The Callendar Group Ltd
28, 31 – 35, 37	Keyford Ltd
44 – 50, 53, 54, 57 - 59	Apollo Communications Ltd
62 – 71, 74, 75, 81	Powerglen Ltd[3]
79 – 80, 82, 83	USM IT Suppliers Ltd
84 - 90	Cyberweb Ltd
91 - 101	BAC Cleaning Services Ltd[4]
102 - 104	Clifton Communications Ltd

[3] In the alternative deal chains put forward by HMRC, the defaulting trader in deals 67 and 75 is identified as USM Suppliers Ltd.

[4] In the alternative deal chains put forward by HMRC, the defaulting trader in deal 93 is identified as RK Brothers Ltd.

107, 108, 111, 117 - 121	iPartner Ltd[5]

69. In some cases the missing trader in a number of deal chains coincided with the same supplier to LMC Ltd in those chains. This was the case in deals 7 – 9 (missing trader RR Investments Ltd; supplier Zain Communications Ltd), deals 17 – 21 (Netforce Technologies; T M Global Ltd), deals 38, 39 and 41 (Euro Imports and Exports Ltd; Zain Communications Ltd), deals 55 – 56 (Anfell College Ltd; Statement Ltd), deals 77 and 78 (Wetherby Fashions Ltd; T M Global Ltd) and deals 109 – 110 (Trade Off Ltd; A1 Computing Ltd).

70. With the exception of one of the alternative deal chains in relation to deal 49, the alternative deal chains do not trace to LMC as broker. Of those referred to above, the alternative deal chains include deals 19 – 21 (Netforce Technologies Ltd), deals 34 and 37 (Keyford Ltd), deals 48 – 50 and 59 (Apollo Communications Ltd), deals 67 and 75 (Powerglen Ltd), deal 77 (Wetherby Fashions Ltd), deals 84 – 87 (Cyberweb Ltd), deals 93 and 98 (BAC Cleaning Services Ltd), deal 104 (Clifton Communications Ltd), deals 109 – 110 (Trade Off Ltd), and deals 11 and 120 (iPartner Ltd).

71. In other cases the chains included a single missing trader, but the suppliers to LMC Ltd varied. Examples are set out in the following table:

Deal number	*Missing trader*	*Suppliers*
31 – 35, 37	Keyford Ltd	T M Global Ltd Crescent UK Ltd Fair General Traders Ltd Zain Communications Ltd
44 – 50, 53, 54, 57 - 59	Apollo Communication Centre Ltd	Zain Communications Ltd Electron Global Ltd T M Global Ltd
62 - 71	Powerglen Ltd	T M Global Ltd Zain Communications Ltd Electron Global Ltd Oakleaze Ltd Cobra Communications Ltd
72, 73, 76, 79, 80, 82, 83	USM IT Suppliers Ltd	Zain Communications Ltd Oakleaze Ltd Cobra Communications

[5] In the alternative deal chains put forward by HMRC, the defaulting trader in deal 111 is identified as Trade Off Ltd.

		Ltd
84 - 90	Cyberweb Ltd	Electron Global Ltd Coast Telecom Ltd Oakleaze Ltd Zain Communications Ltd
91 - 101	BAC Cleaning Services Ltd	Zain Communications Ltd Electron Global Ltd Cobra Communications Ltd Oakleaze Ltd
102 - 104	Clifton Communications Ltd	Oakleaze Ltd Zain Communications Ltd
107, 108, 111, 117 - 121	iPartner Ltd	Cobra Communications Ltd T M Global Ltd Coast Telecom Ltd Oakleaze Ltd
113, 114, 116	Astar Central Ltd	Coast Telecom Ltd Cobra Communications Ltd

72. Of these 67 deals alternative deal chains have been identified in relation to deals 34, 37, 48 – 50, 59, 67, 84 – 87, 93, 98, 104, 111 and 120, a total of 16 deals.

73. In most of the deal chains the same quantity of the same goods were acquired by the missing trader, passed down a chain of buffer traders, purchased by LMC Ltd and exported by LMC. There were a few examples where this straightforward "back to back" dealing did not take place. In deal 1 the defaulting trader made acquisitions of a number of different models of mobile phone in various quantities. The phones in question were 500 units of w800i, 500 units of Samsung D600, 1000 units of PEBL, 150 units of N90, 1900 units of N9300, 200 units of N8800 and 300 units of N6681. LMC Ltd acquired those phones as follows: 200 units of N8800 and 1900 units of N9300 from Zain Communications Ltd; 150 N90 and 300 N6681 from Crescent UK Ltd; 1000 PEBL, 500 Samsung D600 and 500 w800i from T M Global Ltd. These were then all sold to LMC, and all sold on by LMC to a single EC purchaser, Westcom SA. All these transactions, from the acquisition by the missing trader from Pak Shine Import Export LDA to the export sale by LMC, took place on the same day, 9 February 2006.

74. In a few of the deals trading was not back to back, in that the trading did not all take place on the same day. In deal 15, for example LMC Ltd was invoiced by its

supplier, Trans Global Traders Ltd, on 21 February 2006 and the goods were sold to 3G Trade SA on 6 March 2006. Payment was made by LMC Ltd to its supplier on 2 March 2006. Mr Leitch in evidence said that this appeared to have been a case where LMC Ltd had retained the goods in the hope that the price would increase. This deal is also noteworthy for the small number of traders in the chain. In deal 16 there was a trade on 16 February 2006 between RR Investments Ltd and Zeenom Trading Ltd, and a sale by Zeenom to LMC Ltd on the same day. LMC Ltd paid for the goods on 8 March 2006, having sold to LMC on 6 March 2006. On the same day LMC sold and exported to 3G Trade SA.

75. Deal 14, which involved a contra trader, Kensai Trading Ltd, did not conform to the standard pattern. LMC Ltd acquired 6,960 units of Samsung D500 phones from Trans Global Traders Ltd. These were invoiced as to 3,010 on 21 February 2006, 2,950 on 1 March 2006 and 1000 on 2 March 2006. On 23 February 2006, LMC Ltd sold 2,950 units to Atec Associates Ltd, and on 23 February 2006, 55 units to Transalpine Enterprises Ltd. The sale of the 55 units was at a price (£132 per unit) considerably lower than the price of the 2,950 units (£151). Mr Leitch speculated that this might have been due to the 55 having a different specification. Subsequently, on 6 March 2006, LMC Ltd sold 3,955 units to LMC, which sold them in two tranches, of 2,950 and 1,005, on the same day to 3G Trade SA. However, the International Consignment Notes show that, of the tranche of 2,950 units, only 2,945 appear to have been despatched. This then explains a credit note issued by LMC to 3G Trade on 6 March 2006. This is an example, unusual in the context of the deal chains as a whole, where LMC Ltd applied a mark-up in excess of £1 per phone, and where LMC Ltd did not sell all the phones it had acquired to LMC, but instead sold to other broker traders who sold on to different customers outside the UK.

76. In deal 3 a total of 9,600 NEC E616 phones were traded back to back, again through Pak Shine Export Import PDA and the missing trader, Rayzah Ltd in three batches through the buffer traders of RR Investments Ltd, Direct Billing Ltd and Electron Global Ltd. LMC Ltd purchased from Electron in two batches of 4,800 units each. One batch was sold to LMC, the other to Crouch Commodities Ltd. But all 9600 were sold on to the same EC customer, 3G Trade SA. All the transactions took place on a single day, 10 February 2006. We note, with regard to Crouch, that this was a company with which LMC appears to have had a very close relationship. Indeed, the evidence is that Crouch was solely supplied by LMC Ltd, and that all of its onward sales were to EU customers that were also known to LMC.

77. Deal 23 is similar to deal 3. On a single day, 14 March 2006, 2200 units of N9300i phones passed down the chain until LMC Ltd bought them in two tranches of 1125 and 1075. LMC Ltd sold 1125 to Crouch Commodities Ltd and 1075 to LMC. In contrast to deal 3, however, in this case LMC sold to Westcom SA and Crouch sold to World Communications France SARL (also a customer of LMC).

78. In deal 24 a consignment of 5000 N8800 phones was sold in two batches (3000 and 2000) from the missing trader, The Callendar Group Ltd, to MG Components Ltd and from there to RK Brothers Ltd. From there 3000 phones were sold to Guess Trading Ltd and 2000 to Kingfisher Traders Ltd, before the phones were batched

together again by being bought by Xstream Communications Ltd. The 5000 phones were then sold in a single batch to Worldwide Communications Ltd before being acquired by LMC Ltd and then sold by LMC to Francphone SARL. The transactions took place on 14 March 2006. A similar chain arose in deal 25, where two batches of 2000 N9500 phones that started with the missing trader The Callendar Group Ltd, were brought together in a buffer trader, Deb Techno Ltd, before being sold to Data Key Products Ltd and from there to LMC Ltd. LMC sold the whole consignment of 4000 phones to Francphone Ltd.

79. In deal 42, LMC Ltd acted as a buffer for sales to LMC and a third party, ESBAE International Ltd. LMC Ltd acquired 2200 Nokia 9300i in two batches of 1900 and 300, the phones having been traded down the buffers chain in two batches of 1500 and 700. LMC Ltd sold 1900 to ESBAE, which acted as a broker on the sale to World Communications France SARL, and the balance to LMC which sold them to H H Import Export.

80. Deals 44 and 45 are examples of cases where two models of phone were dealt in down the chain, the numbers of each phone being the same at each stage of the transactions. In deal 44 the transactions involved 1700 N6280 phones and 120 K750i phones. Both sets of phones emanated from Universal Systems SCS, a Belgian company, and passed through the hands of a number of traders on 10 April 2006, finally being acquired by LMC Ltd from Zain Communications Ltd before being sold by LMC to Westcom SA. In deal 45, there were 2000 N6230i phones, also emanating from Universal Systems. Those phones were imported into the UK by Apollo Communication Centre Ltd, which also acquired (from a source not identified) 700 PEBL. These batches of these two phones were then transferred down a chain to LMC Ltd and LMC, which sold them to Westcom SA.

81. In deal 51, LMC Ltd acquired 5320 N9300i phones from Global Roaming Ltd. It sold, with a mark-up of £1, 3400 of those phones to LMC, and the balance of 1920 phones to Foneshops Ltd, at a mark-up of 50p. LMC sold its phones to Westcom SA; Foneshops sold its phones to Mobile World GmbH, a company that was also a customer of LMC.

82. Deal 52 has similarities to deals 3 and 23, in that it involved an acquisition by LMC Ltd of two batches of 3400 and 3500 units of N9300i phones from a single supplier, Zain Communications Ltd, that originated in a single batch of 6900 from the missing trader, Worldwide Enterprises Ltd, followed by a sale of 3500 to LMC and 3400 to Crouch Commodities Ltd. All the phones were then sold by LMC and Crouch to a single EC customer, Freitex GmbH & Co KG. LMC Ltd acquired the phones for a unit price of £411.00, and sold them to LMC and Crouch for £412.00. But whereas LMC marked up the price on its sale to Freitex to £420.50, Crouch sold on with no mark up.

83. In deal 64 LMC Ltd acted both as a buffer, selling to LMC, and as a broker. The goods started as a single batch of 8000 units of N8801 phones sold by the missing trader Powerglen Ltd. After passing through EasyMSI Ltd, the phones were split into three batches, of 2000, 3000 and 3000 respectively. In this form they passed through

the buffers Fair General Traders Ltd, Oakleaze Ltd and Zain Communications Ltd, before being acquired by LMC Ltd in four batches (1400, and three of 2200). Of these the two batches, 1400 and 2200, were sold to LMC at a mark up of £1, and the remaining two batches of 2200 each were sold to H H Import Export and World Communications France SARL at a mark up of £10. LMC sold on to Freitex GmbH & Co KG and Mobile World Export at a mark up of £11. All the transactions took place on 27 April 2006.

84. Deal 95 is another example where a single batch, on this occasion of 1000 N70 phones, was split on acquisition by LMC Ltd, with 500 being sold to LMC and 500 to Crouch Commodities Ltd, with a mark up of £1 per unit in each case. In this case the phones had been acquired by a buffer trader at a unit price of £499.75 and sold on at a 25p uplift to LMC Ltd, before the price was effectively reduced to £240 per unit by the issue of a credit note. Each of LMC and Crouch marked the goods up further by £5 per unit before selling on to different EC customers, H H Import Export in the case of LMC, and World Communications France SARL in the case of Crouch.

85. In addition we note, as Mr Fletcher's evidence also noted, that there were instances where LMC allowed one or more new intermediaries into an established supply chain relationship. For example, LMC purchased handsets from TM Global in 23 transactions before allowing Zain Communications to enter this established link in the supply chain. Thus LMC allowed an additional trader to enter and extend the length of the supply chain, eroding LMC's own profit margin. We accept Mr Fletcher's conclusion that this was not consistent with profit-maximising arbitrage trading.

86. The period under question also coincided in a rapid growth in turnover. From having no turnover at all in the majority of the months of 2005, LMC's turnover jumped to £7.5 million in 02/06, to £27.4 million in 03/06, peaking at £37.3 million in 04/06. There was an even more marked increase in the turnover of LMC Ltd; it was £12.4 million in the 01/05 quarter, went to £143.5 million in the 01/06 quarter and peaked at £379.3 million in the 04/06 quarter.

The grey market

87. It is beyond dispute that the trades in question did not form part of the legitimate grey market. Fraud in the deal chains has been admitted, and this means that by definition the trading was outside that legitimate market. The evidence of Mr Fletcher, with which Mr Attenborough broadly agreed and which we accept on this point, is that the legitimate grey market trading comprises one of four kinds: box-breaking, arbitrage, volume shortage (or forecast failure) and dumping. We have also considered the evidence of Mr Attenborough. We find that there was, at the time in question, both legitimate and illegitimate grey market trading in the UK market. There was, as Mr Fletcher accepted, a "vibrant market for grey market trading in the UK"; and he accepted in this respect that the dumping of stock from manufacturers (OEMs), mobile network operators (MNOs) and authorised distributors included cases where the stock would be sold into the same market as that of the OEM, MNO or authorised distributor.

88. Mr Fletcher and Mr Attenborough disagreed over estimation of the size of the legitimate grey market in the UK at the relevant time. Mr Attenborough's approach was to consider the size of the market after the reverse charge had eliminated UK missing traders, and extrapolate from that an estimate of the size of the legitimate grey market in 2006. Mr Fletcher disagreed with that methodology, which in his view ignored the use of the UK as a conduit for missing trader fraud affecting other EU member states. Mr Fletcher's approach was to make an estimate of the maximum number of phones that could have been traded by a grey market trader, starting from a position of retail sales. But he accepted that it was not possible to estimate safely how many phones existed in the whole of the UK market in the period in question. We do not consider it necessary to form a view on the respective approaches adopted by the two expert witnesses. The precise sizes of the legitimate and illegitimate markets are not determinative of these appeals. What is important is that, in the relevant period, as both experts agree, both types of trading existed.

89. Mr Fletcher's evidence was that he did not consider that a material number of handsets were imported on the legitimate grey market and then re-exported. He disagreed with Mr Attenborough's analysis of the UK as a trading hub for this purpose, arguing that there would be no need, in a legitimate market, for a trader based in the UK to import and then re-export phones in a process that involved transhipment of the goods and brought those trades within the scope of UK VAT. We accept Mr Fletcher's analysis in this respect.

90. The increase in the trading in mobile phones that was affected by MTIC fraud was dealt with in Mr Stone's evidence, which was not challenged. The sudden increase in mobile phone deals (including exports) in 2006 consisted of transactions connected to MTIC fraud. The volume of such fraudulent transactions and the resulting tax losses rose and fell in parallel with decisions of the ECJ and the strategy adopted by HMRC to combat MTIC fraud. The fraudulent trade increased after the opinion of the Advocate-General in *Optigen* and *Bond House* in late 2005. After the ECJ's decision in that case in early 2006 it turned into a flood that continued until HMRC expanded their extended verification programme in May 2006 and the ECJ issued its *Kittel* judgment in July 2006.

91. We do not place any reliance on the market share data incorporated into Mr Fletcher's witness statement (at figure 12). This purported to show the market share percentage of LMC's exported handsets by reference to market share data obtained from GfK Marketing Services Ltd, part of the GfK group of market research companies. Data is collected from over 26 countries worldwide by use of links to electronic point of sales systems located in retail outlets. The wholesale market is not tracked, and the data is not comprehensive. The "tracked universe" excludes corporate (or business to business) sales, and a number of other outlets, including the black market and exports. In our view, therefore, these exclusions have the effect that the percentages extrapolated by Mr Fletcher cannot be of material evidential value.

Conduct of the business

92. At the material time the LMC and LMC Ltd businesses were operated primarily by Mr Leitch and Mr Sheridan. Mr Sheridan was the main trader, and also principally engaged in due diligence, and Mr Leitch dealt with paperwork and financial matters. He would deal with all the finances, paying the suppliers, chasing up customers and keeping a general oversight on funds. The business had other employees, namely Lenny Chater, Chris Burton and Danny Sains, who assisted with the trading.

93. No bookkeeper or accountant was employed. Mr Leitch aimed to get the paperwork for the deals in order by the end of the working day. His evidence was that he operated a policy of "whoever shouts loudest gets paid". Mr Leitch accepted that his paperwork was at times deficient; in evidence he accepted that he looked upon Mr Patterson as the person who could keep the accounting straight. Mr Leitch also explained that it was his practice to shred documents on which he had calculated the profits of the business in order to prevent his staff from seeing the profits that the business was earning. Mr Sheridan supported this practice. We view this explanation with some scepticism. Whilst we can see that, for the unincorporated business at least, there might have been a desire not to have been completely transparent with the employees, it does not in our view follow that this would necessitate the shredding of accounting material.

94. Despite extensive evidence given by Mr Leitch and Mr Sheridan, we were unable to form a complete picture as to the way in which deals were actually negotiated on a day-to-day basis in the period in question. We heard that early in the morning of a working day, before arriving at the office, Mr Sheridan would be on the phone to suppliers and customers. He would arrive at the office at about 9.30 am. He would, it was said, sort through hundreds of offers and requests until he could put together some decent trades. We heard of the use of the IPT website, including some stories about how it had been made the object of fun by Mr Leitch and Mr Sheridan. The IPT website enabled the availability of phones to be out on a screen, with immediate effect. Mr Sheridan told us that on occasion, even if the business held no stock, it would post that it did and in that way ascertain what demand there was for that particular item. The business had joined the IPT website in, we believe, 2003, although Mr Sheridan's recollection was that this was in 2004 or 2005. In the early period it had been of great assistance in establishing contact with traders, but by the time of the period subject to these appeals it use was more sporadic, greater reliance being placed on the contacts that had already been built up with traders.

95. In addition, Mr Sheridan's evidence was that the business would contact the freight forwarders who were holding stock to ask them if they knew anyone who had a certain model of mobile phone in stock. Although the freight forwarders would not pass the information on directly, they would inform their clients that LMC (or LMC Ltd) was looking to purchase.

96. In his evidence Mr Leitch agreed that one of the factors was to obtain the best price, but it was not the only factor. He stressed the need to ensure that the counterparties could be trusted to make payment, on time, and not to renege on deals. He also agreed that it was in the export that the real profit lay, but that businesses

would also do back-to-back deals, trading in the day with small mark-ups, in order to ensure that they were not left with stock in case of a drop in market price.

97. It was accepted that ideally LMC would have wished to deal with authorised distributors or with the non-UK company that was importing the goods into the UK, or at least with a trader who was close to the importer, but there was no evidence that this was ever achieved; it was certainly not achieved in any (apart possibly from deal 15) of the deal chains that are in issue in this case. We had no details of the individual negotiations that might have been expected to have been conducted with suppliers and customers, only general assertions that there were hundreds of discussions over the telephone. Indeed, in contrast to Mr Leitch's recall of the one2one deal in his early years of trading, he did not describe in detail any of the individual transactions in these appeals. Mr Leitch sought at one stage to explain his lack of knowledge of individual transactions by saying that over the years he had had hundreds of customers and suppliers; in fact, in the period in question in this appeal the number was very much lower (in the relevant period only 16 suppliers were used, and LMC exported to only 11 customers). Mr Leitch also claimed to have had a good working relationship with the export customers in the deals at issue in this appeal, principally meaning that there had been no issue with payment, but we had no evidence to support these relationships.

98. It was never satisfactorily explained how LMC was able to make a consistently high profit on the transactions in question. Mr Leitch's explanation was unclear, referring generally to dumping of stock, and the fact that markets would always exist, referring in this context to Africa, but there was no explanation of why the consistent mark ups on phones would arise, why traders at the start of a chain would sell for less than the price that could be achieved on export, why traders who had an allocation would part with stock to another UK trader for a small mark up when the IPT website could be used to obtain a greater price from another trader who acquired the stock later in the chain, or why an export customer would always pay a greater price so that the exporter could make a profit consistently higher than that achieved by the other UK traders in the deal chain. We heard evidence about supply and demand, and price fluctuation, but price fluctuation was not evident in the deals we have to consider; the price in almost all cases went in one direction only. Whilst we can understand the need for a UK exporter to obtain a margin to cover the cost of its tied-up capital, a point made by Mr Leitch in his witness statement, an export customer would be expected to pay a market price for the goods, and that market price would not be fixed by reference to the cash flow peculiarity of the UK exporter in having to fund, subject to any credit from its own supplier, the UK VAT prior to repayment of that amount.

99. Whilst it was Mr Sheridan who was primarily responsible for the buying and selling and due diligence, we heard evidence from Mr Leitch that certain deals would be discussed with him, primarily to assess the risks. Those risks, according to Mr Leitch, were the commercial ones, namely whether the price of the phone was likely to go down, could the goods be moved on quickly, and the history of the supplier and customer.

100. Mr Sheridan described the process in a little more detail. He said that, although the IPT website had been a valuable tool at the outset, once reliable suppliers had been identified the practice was to contact those suppliers before they posted stock on the website. In the relevant period, the website was used as a tool for providing market information, more than for making contact with other traders. It assisted the business to obtain the best possible price, although Mr Sheridan also said that regardless of the price advertised on the website LMC would always try to "chip them down", using the inspection reports as a pretext, for example. Whilst this may have been a pattern of trading that LMC had been engaged in, we cannot find that it was in the deals in question, where the consistent mark-ups down the chain would simply not have permitted there to have been any "chipping down" of those prices. We do not therefore, in the context of these transactions, accept Mr Sheridan's evidence on this point. And although it was claimed that the business would always be looking to deal with suppliers who were as close as possible to the importer, so as to avoid the profit margins being diluted by having too many traders in a chain, that trading objective was evidently not achieved, subject to the caveat in relation to deal 15, in the deals in question in these appeals.

101. The business had a number of favoured suppliers; Mr Sheridan named several of those that appear in the deal chains we have summarised. He explained that once a deal had been done then as a rule LMC Ltd would have an allocation sent to it. Mr Sheridan would ring up the freight forwarder to check the allocation was in place. By phone or by fax he would advise that the stock then be allocated to another trader. He would then post on the trading board in the office "allocated to X". The prices having already been fixed, Mr Leitch would then be requested to send the purchase order and invoices.

102. Allocation at the freight forwarders was an important step. Whilst not amounting to ownership, it nevertheless identified the trader to whom the freight forwarder would look for instructions. It also enabled the freight forwarder to identify the goods for inspection, such as by 4G.

103. Mr Sheridan accepted that, by using the IPT website, it would be possible for importers of phones to make contact with exporters and thereby maximise the importer's profits. He explained that, in discussions with suppliers, those suppliers would often claim to be "next to the importer", implying a short chain. This was advantageous commercially, in that it would be easier to obtain releases of stock if the number of suppliers in a chain was limited. However, this form of trading was from an earlier period, ending at about the time that the transactions at issue in this appeal commenced. The new form of trading, according to Mr Sheridan, was that LMC would insist that the stock was released to it prior to payment. This, it appears, would obviate the need for a deal chain to be short simply to obtain speedy releases of stock. The lengthening of the deal chains therefore appears to have been a change in the way trades were carried on.

104. Mr Sheridan was asked to explain how deal chains of the length consistently found in the transactions in question came about. His response was that traders who acquired stock would be looking to make the best possible sale. Although a sale to

another UK trader would result in only a small mark up, this would nevertheless result in acceptable profits because of the substantial quantities of goods being traded. Some traders would not wish to sell to exporters because exporters, having the cash flow issue of waiting for repayment of VAT, would often require credit from their supplier. Mr Sheridan accepted that he was aware, through the trading carried on by LMC and LMC Ltd as buffer traders, that chains of suppliers would be building up.

105. Mr Leitch said that one of his tasks was to consider giving credit to traders. He said that the fact that the business gave credit was one of the factors that made them so busy; it gave the business a place in the market. We can understand this assertion in the context of trades with other UK entities, where LMC or LMC Ltd might act as a buffer trader, and not as an exporter, but it does not make sense to us in relation to the trades in question, where LMC Ltd's only creditor was, as a general rule, LMC, and LMC's creditor was an overseas buyer. Nor does it make sense in the context of LMC not undertaking credit checks.

106. Not all of LMC's trades in the relevant period were successfully executed. Subject to our earlier observations, certain of the deals (up to 49) appear to have been cancelled, and at least on one occasion LMC suffered a loss. A note of a visit of Mr Patterson on 12 April 2006 to new premises of LMC and LMC Ltd in Billericay, which are recorded as having cost in the region of £80,000 to move to and equip, states: "Trader now only sells to customers who pay in advance – no credit offered. He has got stung again, another large loss."

107. In the same context, but in respect of trading before the relevant period, we were referred to issues that had arisen in respect of a trading transaction with a company called Optime Strategies Limited, to which we referred earlier in relation to a cancelled deal. On 13 October 2005, Mr Sheridan, for LMC Ltd, had written to that company to set out proposals for financial compensation in respect of that cancelled deal. Optime, LMC Ltd's customer, were, in their own words, "relatively new in the mobile phone business" but were the broker in the deal and had been permitted by LMC Ltd, which retained ownership, to export certain mobile phones to Germany ship on hold, subject to a full inspection and insurance. Payment was not received from Optime, and Mr Sheridan had refused to deal with the end purchaser in the chain, in particular refusing to accept a third party payment from that purchaser, instead suggesting that the goods could be released in stages on payments being made down the chain. As a result, LMC Ltd suffered loss, both in not receiving payment from Optime and in shipping the goods back from Germany.

Due diligence

108. Much of the cross-examination, particularly that of Mr Sheridan, focussed on due diligence. Mindful of what Moses LJ said in *Mobilx*, we do not here record in detail the detailed examination of individual deals from the perspective of due diligence carried out or not carried out. Instead we will summarise certain features only which we regard as material to our decision.

109. We have referred earlier to the visit by Mr Patterson on 18 April 2005, and to the completion of aides memoires in respect of both LMC and LMC Ltd. These were comprehensive questionnaires comprising 213 questions covering all aspects of the business, including questions regarding the integrity of the supply chains. Mr Leitch's responses to these questions can be described as terse and uninformative. When asked, for example, what reasonable steps LMC took to ensure the integrity of the deal chains he described ringing other suppliers and customers, visiting suppliers, Redhill VRN checks and freight forwarder checks. When asked directly to give a reason why each supplier could obtain goods on each occasion cheaper than themselves or the customers, the response was simply "just get them cheaper". Mr Leitch confirmed that no credit checks were made. In cross-examination Mr Leitch said that he was not doing his best to give accurate answers as he was busy with the normal business of the day.

110. In his evidence Mr Sheridan similarly described the due diligence in 2005 as consisting of a VRN check and checks with other suppliers and freight forwarders. The enquiries of the freight forwarders were in part designed to identify possible carousel fraud. The example given was of a client in Germany wishing to purchase phones; if on enquiry of the freight forwarder it was ascertained that the phones emanated from Germany, LMC would not do the trade.

111. Also on 18 April 2005 Mr Patterson handed to Mr Sheridan a copy of Notice 726, as we have described. In evidence it was apparent that both Mr Leitch and Mr Sheridan misunderstood the significance of liability potentially being joint and several. Indeed, Mr Leitch accepted that he had not read Notice 726. In his witness statement Mr Sheridan said:

> "Although we were aware of the carousel fraud and the provisions of joint and several liability, I had understood those and the decision in Bond House to mean that if we slipped up in our due diligence and got caught up in a bad chain, every trader in that chain would have to pay a proportion of that VAT. We thought highly of our due diligence processes but we know that no system is perfect. We reasoned that we could stand the risk of this type of payment if any bad deals managed to slip through."

112. In answer to the Tribunal, Mr Sheridan said that he and Mr Leitch "genuinely thought that if there was six people in the chain, two people in the chain, it would be whoever – if someone defaulted and didn't pay, it was everybody's peril, jointly, was our understanding." When asked if the 50% risk that would arise if there were only two people in the chain would be acceptable in these terms, Mr Sheridan confirmed that it was.

113. What we conclude from this element of Mr Sheridan's evidence was that LMC knew very well that the chains of transactions extended well beyond the immediate supplier of LMC Ltd; the reference to six people in the chain is, we consider, not coincidental, but strongly indicative of knowledge of the actual structure of the deal chains. Even on Mr Sheridan's own faulty analysis of the impact of joint and several liability, the structure adopted by the business of involving both LMC and LMC Ltd

in the deals would have led to an increase of the businesses' potential liability compared with the position if only one of LMC and LMC Ltd had been involved. We consider that the attitude to risk was predicated on the knowledge that the chains would be sufficiently long to reduce, on that wrong understanding, that liability to manageable amounts.

114. We were provided with schedules prepared by Mr Patterson which analyse the documents relating to due diligence that were provided by LMC and LMC Ltd to HMRC. These schedules set out, for each supplier and customer in the period from February to July 2006, the nature of the due diligence checks made, the date of those checks, the date of the first transaction with the company concerned, and extracts from the reports said to show negative indications.

115. As a general matter we find that the dates set out in Mr Patterson's schedule are reliable. There is no universal pattern. Generally speaking, however, and with some exceptions, we find that the Redhill verification checks were in most cases made in advance of a trade, though in relation to some traders the checks had been made some time prior to the trade, and would have been reasonably expected to have been updated. As far as due diligence reports go, the picture for suppliers is mixed; due diligence reports were received on some suppliers before the date of the first trade, and some updated afterwards, whereas for others no due diligence report was received by the time of the first trade, and a report was made only belatedly. A more distinct pattern can be discerned in relation to customers, particularly those outside the UK. In most of those cases, although in some a Redhill verification had been obtained in advance, due diligence reports generally post-dated the date of the first trade. In his evidence, Mr Sheridan said that LMC conducted trades before receiving the due diligence report "pretty much all the time". The explanation was that, in many cases, a trading relationship had already been established.

116. Following indications from Mr Patterson in February 2006 (which related to issues with a company called Eyedial Ltd, to which we return later), the need for due diligence was recognised, and the business was taking steps to have due diligence reports made by one due diligence provider (Veracis or JDS) and confirmed by the other. Reports were made on companies that LMC had traded with in the past, as well as on new trading partners. Mr Sheridan explained that, following the Eyedial correspondence, he asked Veracis (who had done the inspection report on Eyedial) to review LMC's due diligence. There was a discussion on due diligence generally, and Notice 726. As a result, from April 2006, a new due diligence exercise was commenced, with trade application forms being sent to existing contacts, and trade references being refreshed.

117. We were shown, as a late addition to Mr Sheridan's evidence, a copy of a letter from LMC Ltd dated 31 August 2006, addressed to a Mr Dave Whisson of Cybacomms International Ltd in which Mr Leitch refers to an issue raised by Cybacomms in relation to certain trades, and seeks to reassure Mr Whisson of the due diligence procedures being undertaken by LMC Ltd. With that letter there was enclosed a copy of the due diligence procedures as at 1 March 2006:

> "(A) All companies must formally introduce themselves to us in writing including a copy of their Vat certificate, Company registration certificate (if applicable), Bank details
>
> (B) Upon receiving A, London Mobile Communications Ltd replies to them formally introducing them and sends a copy of its company documents and a trade application form
>
> (C) All documentation received in A is faxed to HMRC – Redhill for verification
>
> (D) Upon receipt of a completed trade application form and Vat confirmation from HMRC – Redhill we then contact the trade references supplied in completed trade application form.
>
> (E) Upon satisfactory trade references being obtained we then instruct one or both of our due diligence agents (which are Jds Consultants Ltd and Veracis Ltd) to conduct a site visit and due diligence report
>
> (F) Upon receipt of the due diligence report we then study it in detail [to] ascertain the following:
>
> What due diligence our suppliers/customers do on their suppliers/customers,
>
> Does the company receive or make third party payments? (note if they do their application will be declined).
>
> Does the company have a good understanding of Joint and several liability? (if they do not, their application will be declined and ask them to reapply after 30 [days?] subject to them having sufficient knowledge of Joint and several liability).
>
> How long has the company been trading?
>
> Does the company have sufficient funds to honour their invoices and what is their turnover for previous business and estimated for the future?
>
> What are the business premises like?
>
> Do we have sufficient proof of identification for the directors of these companies?
>
> Does the company have a good understanding of the telecommunications industry?
>
> Assuming we are satisfied with all the above, then an account will be opened and they [will] be designated a dealer manager and trading commences.
>
> The customer dealer manager asks them of any changes to their company at the beginning of every month and all changes are noted.
>
> Every three months our due diligence agents re-attend their premises and conduct an up to date report."

118. Whilst accepting that the letter to Cybacomms was genuine, in cross-examination of Mr Sheridan Mr Vere-Hodge put HMRC's case that the attached copy of the due diligence procedures was not genuine. We find that it was genuine. It is

consistent with Mr Sheridan's evidence, which in this respect we accept, that new procedures were introduced in March or April 2006, following the Eyedial correspondence and Notice 726. Mr Leitch said that the industry was changing, and that he was doing his best, including bringing in new, more formalised, due diligence procedures.

119. It was put to Mr Sheridan that the new due diligence process was not adhered to. Mr Sheridan said that it was, but only in relation to new potential suppliers and customers. Although the note referred to companies in general, the new procedure was intended to operate for new companies, and would be applied over a period to the existing trading contact base. He also accepted, in cross-examination, that the requirement for company verification was not universally observed, and that a letter of introduction was not sent in every case.

120. Much of the evidence in cross-examination concerned the failure by LMC to act on the negative indicators said to be highlighted in the due diligence reports. To the extent that the reports themselves post-dated the relevant period, that cannot in our view be material to our present consideration, but it is relevant in respect of those reports that were made before or during that period.

121. In cross-examination Mr Sheridan conceded that certain of the due diligence reports contained indications that ought to have been considered negative, but were not viewed in that way at the time. By way of example, in relation to Crouch Commodities Ltd, Mr Sheridan accepted that a failure to provide details of the previous year's turnover should have been considered a negative indicator. He also accepted that the reference to Crouch having a "small supply chain" ought not to have been accepted at face value. Furthermore, in relation to "credit score" the report indicated that a risk score was unavailable, and the figures revealed showed only £37,519 in the bank. Yet Crouch was a company to which LMC extended considerable credit.

122. We were taken to a number of examples of due diligence reports carried out, in most cases belatedly, in relation to EU customers of LMC. One example was for Freitex GmbH & Co KG, a customer that first featured in the deal chains at issue on 13 April 2006, and which was a customer of LMC in nine further deals, the final one of which was on 22 June 2006. In that case the Redhill VRN check was confirmed by HMRC on 12 April 2006, just before the first deal. A due diligence visit was made by JDS on 8 June 2006, well after most of the deals. There is no date on the report itself. The report provided as positive points: copy of passport provided with documentation; copy of utility bill for business/home address; good friendly demeanour; father allowed to be photographed; no ongoing issues with Customs; and scan IMEIs. The negative points were: details of last year's turnover/profit unknown; not enough staff; no company office for Freitex; insufficient due diligence – basic trading application; and no supplier declaration provided. Mr Leitch accepted that, if this report had been received before any deals had been done with Freitex, LMC would not have traded with them.

123. In many cases, even where due diligence was done before trading commenced, or a particular trade was made, negative indications in the due diligence reports were ignored, and trading either commenced or continued with the suppliers and customers concerned. This can be explained to some extent, but not wholly, by the fact that some of the traders for whom due diligence had been carried out were in any event well known to Mr Leitch or Mr Sheridan or both, or by a view being taken that certain of the negative indicators were not sufficient to mean that trading should cease.

124. In certain respects, however, LMC and LMC Ltd did act. We were referred to one example, before the periods in question, where a trading relationship with a company called Sellmex Ltd was terminated on account of adverse indications contained in a due diligence report by Veracis Limited in September 2005. On 24 November 2005, Mr Leitch wrote to Sellmex, to query discrepancies in trading addresses, and a statement that the company was making third party payments. Mr Leitch's letter states that until these matters have been resolved the trading relationship will be terminated. The reply from Sellmex referred only to not making third party payments on transactions with LMC Ltd. Mr Leitch replied on 25 November 2005 insisting that no third payments be made on any trades.

125. This was one example was in those cases where the due diligence report indicated that a company had been involved in third party payments. There are further examples from the period in question. Handwritten notes on certain of the due diligence reports, and VRN letters, indicate that Mr Sheridan had noted that a trading should not be carried out with a particular trader in certain circumstances. An example is Allegro Investments, where Mr Sheridan had written on the validation letter, firstly "Not much trading done. Came highly recommended in trade", and then underneath a handwritten line "Due diligence not up to scratch. Account closed by Matthew 21/09/06". Another example was Crescent UK, where handwritten notes are made on the Veracis report to the effect that there were issues with that company's knowledge about joint and several liability and its compliance with due diligence.

126. Mr Vere-Hodge made, and maintained, an argument that these notes were not contemporaneous, and should not be relied upon. As Mr Rees submitted, this is a serious allegation, and it is one therefore that we must address. We have no hesitation in finding that these notes were genuine. It is clear to us that Mr Sheridan was in the habit, when he did so, of writing notes on whatever piece of paper happened to be in the file. These were comments that sometimes related to due diligence or other matters that might go to the integrity of the deal chains, but at other times were simply commercial notes, such as the note relating to Fonestop "Sometimes releases slow". There is no contradiction in the notes made regarding Allegro Investments; those notes were, as we find, simply made at different times. Nor do we consider that the late production of the handwritten comments throws any doubt on their genuineness: it is perfectly possible, and we find that this is what happened, that when the documents were originally photocopied for HMRC, they were put into a feeder on the copier and only one side of each page was copied, thus leaving the handwritten comments on the back of certain pages uncopied.

127. On the other hand, there were only very few examples of where notes had been made on due diligence reports, or other due diligence documentation. Out of all the due diligence material we received evidence of only 14 cases where handwritten notes had been added.

128. Another example of LMC ceasing to deal with a particular trader is Electron Global Ltd. In relation to that company, Mr Patterson wrote to LMC Ltd on 22 May 2006 to put the company on notice that a tax loss had been identified in the trading chains, and that one of the trading companies with a connection to a tax loss was Electron Global. The last occasion on which LMC or LMC Ltd dealt with Electron Global was 19 May 2006. Mr Sheridan's evidence on this point, which we accept, was that on the basis that Electron Global had not given a satisfactory answer to what had been said, trading ceased, even though the trader had been a good supplier in the past, and otherwise LMC Ltd would have been keen to continue trading with that trader.

129. We were shown correspondence from Mr Sheridan, for LMC Ltd, to a Mr Puri at Electron Global. In a letter of 6 August 2006 Mr Sheridan referred to a due diligence report by JDS. That report followed a visit by JDS to Electron Global on 24 July 2006, indicating that, despite the earlier indication of connection to fraud, Electron Global was being reconsidered as a potential trading partner. The letter goes on to express concern that the company, and its employee Mr Baimani, do not have sufficient knowledge of Notice 726. It also refers to the connection to fraud in previous deal chains.

130. That was not the only example of Mr Sheridan writing to traders to advise them that indications had been received that transactions undertaken by LMC had some missing or defaulting traders in the supply chain. Another example, from August 2006, is a letter to Black Country Trading Ltd. This letter is somewhat self-serving, referring as it does to the fact that LMC Ltd is a very established company, building up an excellence in trading and due diligence, and insisting that all trading is done in a professional and honest manner. The letter requests the recipient to make checks on all their suppliers and review their own supply chains, and seeks confirmation that this has been done.

131. We were taken to various documents relating to a trader by the name of Easy MSI Ltd, which appears on a number of occasions as a buffer in the deal chains. Easy MSI had contacted LMC with a view to trading, saying that it was at the forefront of efficient trading of electronic items, such as MP3 players and memory cards. It enclosed a certificate of incorporation, VAT registration certificate and banking details. LMC Ltd had sent these materials to Redhill for a VRN check on 13 February 2006, but at a later stage Mr Sheridan had written on that letter "Declined. No ref obtained and gut feeling."

132. In general we find that the due diligence reports were wholly inadequate for their purpose of alerting a business to the possibility of becoming connected to fraudulent transactions. A reasonable businessman would have considered them to be worthless. In our view the only purpose of the reports was to seek to satisfy HMRC

that a trader had taken reasonable steps so as to comply with Notice 726. In evidence Mr Patterson confirmed that both Mr Leitch and Mr Sheridan had told him that they were anxious to do what Mr Patterson expected them to do by way of due diligence. We find that that was the real reason for the due diligence; not to avoid any risk of connection to fraud.

133. The due diligence reports relied, almost exclusively, on interviews with the directors or employees of the trader concerned. Very little, if any, independent corroboration was sought or obtained. Even if the reports had contained no negative indicators, we consider that a reasonable businessmen would not have relied upon them as a means of avoiding becoming connected to fraud. But where the reports, having themselves been compiled in this essentially superficial manner, nevertheless highlighted negative factors, those factors would, in our view, have demonstrated to a reasonable businessman that there was a risk of continuing to trade with the trader concerned.

134. We found Mr Leitch's attitude to due diligence instructive. He explained, and we accept, that when he started in the phone industry, no due diligence was required. Everything was done on what he described as "gut instinct"; the prime issues being payment and fair dealing. This had continued even as the business expanded. Mr Leitch accepted that the industry had changed at the time in question, and that he was attempting to move with the times, but he put forward his view that a due diligence report was not going to prevent the fraudulent evasion of VAT, whatever it might contain. Mr Leitch's attitude was that it was not for him to do the job of HMRC to collect VAT. He did not accept that the due diligence that was undertaken was not thorough. But, on the other hand, he did accept that there were misrepresentations in the responses given by LMC Ltd itself to due diligence questions posed by JDS acting on behalf of Crouch Commodities Ltd. From that we infer that both Mr Leitch and Mr Sheridan must have known that these reports were inherently unreliable.

Notification of inadequacy of due diligence

135. On 14 February 2006 Mr Patterson visited LMC in response to a VRN request concerning a company called Eyedial Ltd. At that meeting Mr Patterson advised Mr Leitch that a number of deals involving Eyedial had included a defaulting trader. On 17 February 2006, HMRC sent LMC Ltd a letter confirming the position. It stated that of 17 transactions of LMC Ltd in the periods 07/05, 10/05 and November and December 2005 selected for verification, it had been established that 6 commenced with defaulting traders and that a total of 204 purchase invoices in the period August – December 2005 in which a tax loss of more that £10.6 million had been identified within the chain of transactions. One of the 7 suppliers of those invoices was Eyedial Ltd.

136. The purpose of the letter of 17 February was to warn LMC Ltd about the possible application of the joint and several liability provisions. The letter stated:

> "As explained in Notice 726, where you have genuinely done everything you can to check the integrity of the supply chain, can

> demonstrate you have done so, have taken heed of any indications that VAT may go unpaid, and have no other reason to suspect VAT may go unpaid, the joint and several liability measure will not be applied to you.
>
> However, if you knew, or had reasonable grounds to suspect, that VAT would go unpaid then the measure can be applied to you. From your records you will be able to ascertain who supplied you with the goods detailed above, and you may wish to consider what appropriate action is needed to ensure that VAT does not go unpaid in respect of any future transactions."

137. On 22 February 2006 Dass Solicitors wrote to Mr Patterson asserting that LMC Ltd had genuinely done everything. They asked for clarification whether the businesses which had supplied LMC Ltd in the transactions, which were the subject of the letter, had accounted for their VAT liability and what steps had been taken against the alleged defaulting traders and against those companies which had purchased goods directly from those alleged defaulters. Mr Patterson replied on 28 February 2006 stating that he was unable to confirm whether the joint and several liability provisions would be applied but that the letter had been issued in order to provide knowledge to LMC Ltd regardless of any due diligence checks conducted. Mr Patterson was unable to provide further information, including in relation to defaulting traders, because of "commercial confidentiality"

138. The letter of 17 February was discussed at a meeting at LMC on 22 February 2006. Mr Patterson advised Mr Leitch that whatever due diligence checks he was carrying out could not be working. Mr Patterson said that the only absolute guarantee of not becoming connected to fraud would be to leave the phone trading sector. Mr Leitch responded that he would carry on.

139. This reference by Mr Leitch to carrying on was accepted by Mr Patterson as meaning that LMC and LMC Ltd would carry on trading. We find that this was what Mr Leitch meant, but that such an intention was in the knowledge that particular transactions had been traced to fraud, and that the due diligence that had been undertaken had not prevented this from occurring. As we have described, Mr Leitch himself stated in evidence that he did not consider that due diligence could prevent transactions being connected to fraud.

Financing

140. According to the statement of affairs produced by LMC Ltd's liquidators, the company's unsecured debts included £3 million due to Big GSM East Trading LLC and £9 million to One World, both of which are Dubai-based companies. These loans were unsecured loans, which were made to LMC Ltd (and not to Mr Leitch as sole trader), and were not guaranteed by Mr Leitch. Mr Leitch claimed that the loans were unsolicited and that he decided to enter into them to fund the large volume of trade the LMC business was undertaking. His evidence in cross-examination was that he took the loans simply because he had been offered the facility, in spite of the fact that the business was trading very profitably without external finance. It appears that the loans enabled Mr Leitch and Mr Sheridan themselves to extract cash from the

business whilst continuing to expand the number of transactions undertaken at this time. Mr Sheridan accepted that the loans were used to finance back to back transactions.

141. The statement of affairs also records that Mr Leitch owed LMC Ltd £8,340,202. Mr Leitch explained that this loan was made using the monies received from the Dubai lenders "to try and keep the books straight". It is evident, and we find, that part of the purpose in making the loans was to finance LMC as well as LMC Ltd, and that the loan from LMC Ltd was to achieve this. This enabled LMC to finance the cash flow required to enable export sales to be made, with the delay in repayment of VAT.

142. The loans were unsecured. We heard from Mr Sheridan that there had been some discussion of a debenture, but this was not put in place. Instead, a loan agreement was entered into, subject to the governing law of the UAE, which was not couched in terms commonly associated with such documents in a corporate financial transaction of such a size. The interest rates on the loans were high, at 2.5% per month, but Mr Leitch said that he considered that the deal was worth it for him because his rate of return was greater. We find that this is a reference, not to the profitability of LMC Ltd alone (which was modest because it was not engaged, for the most part, in export business) but to the profitability of the business as a whole, including that of LMC. The loans also amortised and were expressed to be repayable in monthly instalments over a one-year period.

143. The provenance of these loans, and the steps taken by LMC Ltd and LMC to check the bona fides of the lenders, were not satisfactorily explained. The initial contact was Mr Sheridan, but Mr Leitch also confirmed that the companies were known to him. Mr Sheridan's evidence was that he travelled to Dubai with a conservative version of the profitability figures and a list of potential buyers and sellers. Negotiations were by telephone and at a meeting in Dubai; there was no documentary evidence of the negotiations.

144. Mr Leitch's explanation of why the loans were made, which we find unconvincing, is that the loans were offered by the Dubai companies because they were no longer able to trade with LMC, the reason being that Customs would routinely prevent stock being exported to Dubai. We do not accept that an inability to trade would lead to a financing deal. While the circumstances may be true, we do not accept that this was the reason for the financing. The reason given by Mr Leitch for accepting the loan is also unconvincing, and indeed is in marked contrast to the attitude apparently taken by Mr Sheridan in relation to unsolicited offers of credit by traders seeking to deal with LMC.

145. We find that these loans were uncommercial, and not consistent with ordinary trading or ordinary financing of trading companies. Unless the lenders knew that there was no risk in making the loans, unsecured and without any personal guarantee, no reasonable lender, offering commercial finance, would have lent to LMC Ltd on those terms. The explanation offered by Mr Leitch, that these loans were made to LMC Ltd because of the trusted position the business had in the market, is not credible in the face of the uncommercial nature of the loans themselves.

146. We also find support for our rejection of LMC's evidence in relation to these loans by the unclear and, we consider, evasive response offered by Mr Leitch to questions put in cross-examination as to the purpose of a trip in June 2006 to Dubai. Mr Leitch could only say that "more likely than not" he and Mr Sheridan, along with an employee, Danny Sains, were visiting One World and Big GSM and to try and establish more contacts. There was a similar lack of clarity in respect of an earlier trip to Dubai in May 2006.

Banking

147. LMC and LMC Ltd made all payments for the transactions in issue through the First Curacao International Bank. In the absence of any evidence as to the money flows within those accounts, we do not consider that the mere use of that account is material to our determination.

Stock purchase and allocation

148. The evidence of Mr Leitch was that when a lot of stock was available LMC would call for all the stock in an attempt to take it off the market. They would seek to achieve this by obtaining allocations of stock at the freight forwarders. If no sale could be made, LMC would make an excuse to the effect that the stock was no good, and return it to the supplier. Mr Leitch explained that none of this would be documented; all such dealings would be done over the phone with the freight forwarder.

149. It was also asserted that stock would be paid for up front and that deposits would be both placed and taken. Whatever the practice of LMC over a longer period, we find no evidence of deposits for stock in the transactions that are the subject of this appeal. Nor do we accept that in the relevant period there was any significant trading that was not completely back to back. Even in those few instances where the numbers of phones flowing down the supply chain were not identical, there was sufficient congruity to negate any suggestion that LMC was buying stock forward and then splitting it to sell to different traders. The evidence, for the vast majority of the transactions in question, is that the numbers of phones acquired by LMC Ltd and LMC exactly matched the numbers of phones sold by LMC.

Product specifications

150. Mr Fletcher's evidence, which we accept in this respect, was that, in an ordinary commercial transaction the goods would have to be specified to an appropriate level of detail. Failure to do so risks misunderstandings that could leave the supplier with a customer who rejects the goods or who requires modifications with cost implications before accepting them. The commercial and financial risk is greatly increased when the goods have been exported. Mr Fletcher's evidence was that an appropriate degree of detail would include, at a minimum, the handset model and variant (for example, colour), the regions covered by the warranty, and the absence or inclusion of a charger, battery, CD and manual.

151. Mr Fletcher analysed all the relevant purchase orders and invoices issued to or by LMC and LMC Ltd. His analysis, which is summarised at Figure 13 of his witness statement, is that the level of detail and consistency on the documents was wholly inadequate.

152. Mr Fletcher examined 149 purchase order details from LMC Ltd to its suppliers, 168 invoice details from the supplier to LMC Ltd, 139 purchase order details from LMC's customers to LMC and 158 invoice details from LMC to their customers. His findings, which we accept, can be summarised as follows:

(a) In all of the purchase order details from LMC Ltd to its suppliers information such as model and quantity were included. Confirmation of whether the handset should have been "SIM free" and the geographic specification were given on 22 purchase order details. Colour was specified on just 10. In no instance were details given of any type of charger, warranty, manual languages, or the presence of a MB chip or other accessories.

(b) Of the 139 purchase order details from LMC's customers that were reviewed, all specified the quantity of the handset required, and all but one (for "Motorola") specified the model. Thirty-six specified that the handset should be SIM free whilst only 18 specified a colour and 16 mentioned the warranty. No purchase order details contained information about the accessories and only five mentioned the type of charger required.

(c) All 158 of LMC's invoices to customers identified brand, model and quantity. Only 30 gave geographical specifications, 18 specified the colour and five mentioned a charger or warranty.

(d) Of the 168 invoice details received from the supplier, all identified brand and model. Only 24 specified SIM free status, seven the charger and two the colour. None of the invoice details specified whether the handset was new, the software or manual languages, the type of warranty, battery or other accessories included.

153. As Mr Fletcher records, for some of the transactions involving Nokia handsets, the following terms were used by LMC, the suppliers and customers: "EU spec", "Central Euro", Euro, Central Euro Spec, Central European, and "Original EURO Stock". Mr Fletcher's evidence, which we accept, is that Nokia manufactured several variants of handset for the European market. Information from Nokia is that generic terms such as "euro Spec" and "Central Euro Spec" used by LMC in its deal documentation did not match the specifications used by Nokia to describe its stock. In evidence Mr Leitch was unable to explain, apart from surmising that it related to language, what was meant by "Euro spec" on a purchase order from 3G Trade dated 10 February 2006.

154. In his evidence Mr Sheridan acknowledged that the absence of a complete specification could give rise to commercial problems, particularly in the case of an exporter. If the phones were rejected by the customer, a cost of shipping them back to

the UK would arise. But Mr Sheridan said that problems such as wrong languages could be cured by hiring someone to install the correct languages, or by replacing chargers, for example. He explained that agreement on specification would typically be oral and reliance was instead placed on inspection; inspection reports would be obtained before shipping the goods, and a copy would be supplied to the customer. However, we saw no evidence of that practice being followed. To the extent the inspection reports were sent to the customer in advance, were reliable (and we entertain doubts about that – see below), and did not themselves contradict specifications on purchase orders and invoices, we could have accepted that they would have been sufficient to identify, and most likely forestall, the shipping of goods which did not meet the customer's requirements. But in the absence of evidence that the customer was given an opportunity to consider the inspection reports, or any evidence that the goods were in any case returned as a consequence of an inspection report, we conclude that the inspection reports did not perform a useful function in this regard. Nor do we regard as commercially credible the explanation that problems could readily be fixed after the goods had been exported.

155. We find that the specification of the phones on the invoices, purchase orders etc, along with the absence of any other credible method of agreeing the precise specification, is not indicative of normal profitable trading. An export customer would take steps to make sure that the goods it was ordering were clearly specified. A trader engaged in normal trading would seek to minimise risk by ensuring that its purchase order contained sufficient information to ensure that it matched the order received from the customer. Invoices are less important, unless they are themselves the contractual documents. Reliance on telephone discussions and inspections is not consistent, in our view, with a normal commercial attitude to risk.

Deal documentation

156. We were provided with documentation, supplied by LMC to HMRC, relating to the transactions carried out by LMC and LMC Ltd in the relevant period. This included purchase orders, invoices, release notes, and CMRs. From this, relying in part on fax headers that showed the date and time they were despatched, HMRC produced a schedule that, amongst other things, contained an analysis of the arrangement of the transactions. The schedule compares the date, timing, product details and other essential information from each document on a deal by deal basis, cross-referenced to the underlying documents. We directed in the hearing that questions be put to Mr Leitch and Mr Sheridan only on the documents themselves, and not on the summary in the schedule, and we have ourselves considered the underlying documents. The schedule is nevertheless a helpful aid to identifying the case made by HMRC in this respect.

157. In his closing submissions Mr Vere-Hodge drew our attention to a number of examples where he said that the contents of the documents, and/or their sequence of creation and transmission, were such that they could not have fulfilled their ostensible functions of recording the terms of the transactions and transmitting vital information such as instructions to release and ship the goods. We record here those particular examples:

(a) *Deal 1*

LMC Ltd sent its supplier a purchase order specifying a price per unit £100 higher than that stated on the corresponding invoice.

(b) *Deal 3*

LMC Ltd sent its supplier a purchase order at 13.25 on 10 February 2006 when it had already invoiced its customer for the goods in question at 08.25 that morning.

(c) *Deal 5*

The supplier (Zain Communications Ltd) had already released the goods to LMC Ltd before LMC Ltd issued a purchase order.

(d) *Deal 6*

The supplier (T M Global Ltd) faxed its invoice to LMC Ltd at 05.57 on 20 February 2006 but did not receive LMC Ltd's purchase order until 12.05 that afternoon.

(e) *Deal 7*

The supplier (Zain Communications Ltd) released the goods to LMC Ltd at 11.35 on 21 February 2006 but did not receive LMC Ltd's purchase order until 12.45 that afternoon.

(f) *Deal 9*

The supplier (again Zain Communications) released the goods to LMC Ltd at 11.49 on 21 February 2006 but did not receive LMC Ltd's purchase order until 14.44.

158. We are satisfied, from our own review of the documentation, that in many cases there are discrepancies in the contractual arrangements that, in a normal arm's length transaction, would give rise to concern as to the risks being run.

Inspections

159. We received evidence of inspection reports in respect of inspections carried out on a number of consignments of the relevant goods by 4G UK Ltd. As we have described, inspections took place in respect of goods allocated to a trader at the freight forwarders. The inspection company would simply be instructed to inspect the goods, and make a report; no details were given to the inspection company of the trade or of the agreed specification.

160. The evidence of Mr Kirkby, which was not challenged, is that Officer Pearce, the controlling officer for 4G UK Ltd, doubts the possibility that 4G was able to carry

out the level of inspections they purported to undertake. He points to the level of staff 4G apparently employed in the period 04/06, namely 27 part-time staff. This figure was accepted by Mr Leitch. There is evidence, on the other hand, that on 27 April 2006, 4G inspected 30,800 phones on behalf of LMC Ltd and 19,200 on behalf of LMC.

161. How 4G could have completed such an inspection was not satisfactorily explained. Mr Leitch suggested that they might have brought in more staff. The inspection reports typically described themselves as "100% inspections" and reported that "everything was alright", but Mr Leitch suggested that "100% inspection" might simply be to count the boxes, and not to inspect the phones themselves, for example for model, colour etc. But he was unable to say what instruction had been given to 4G in this respect. Mr Sheridan, in his evidence, acknowledged that, as a matter of human nature, 4G might have cut the odd corner, but he was himself nevertheless confident that 4G had the capacity to do all the inspections.

162. As an example of a typical inspection report was produced in relation to deal 1, which involved a sale by LMC of a number of different models of phone. The invoice from LMC dated 9 February 2006 simply sets out the quantity and make of phone. The same is true of the purchase order from Westcom SA of the same date. One of the makes of phone was a Nokia 6681. The inspection report records colour, country of manufacture, a German manual, a keypad language of English and handset languages of English, German and Turkish. A 100% box count is recorded, but no IMEIs scanned. No accessories are noted. The comment is made (which was commonly seen): "Everything was alright". Mr Sheridan explained that this indicated to him that there was a Central European specification (although we have found that such a term was meaningless to Nokia, the manufacturer); he said that this indicated that it would include the most common languages.

163. We entertain doubts about the capacity of 4G to carry out detailed inspection checks of the nature that are purported to have been done. We are therefore doubtful that all of the inspection reports truthfully evidenced an inspection of the nature recorded. In some instances the reports were more detailed, but those details contradicted the specifications stated on the corresponding purchase orders or invoices. As examples, such contradictions are evident in six of the transactions in March 2006. In three the colour of the handsets were not as specified in the purchase order of the EC customer, and in another three the purchase orders required the goods to be "brand new" but the inspection reports described their condition as merely "good". Language specifications were often not met. Although in his evidence Mr Sheridan said that if the inspection did not match the specification the deal would be rejected, or else LMC would nevertheless buy the phones and hope to sell elsewhere, there was no evidence that LMC acted on or queried these inspection reports or that EC customers raised the discrepancies with LMC.

IMEI numbers

164. IMEI stands for International Mobile Equipment Identity. It is a number unique to every mobile phone. It is usually found printed on the phone underneath the

battery and can also be found by dialling a particular sequence into the phone. The significance of IMEI numbers lies in the fact that they are stored on an HMRC database, called NEMESIS, which went live around February 2006. HMRC has a programme of scanning bar codes which NEMESIS can store and match the unique serial numbers. These bar codes are normally found on the outer carton or retail box.

165. As a result of the scanning exercises carried out by HMRC and comparison of the results on the MEMESIS database, it has been established that sometimes the same broker will handle the same phone on a number of occasions. When HMRC examine or scan a carton of phones they should also mark it with an HMRC stamp to ensure that in the future all parties know that the consignment has been examined by HMRC. Some traders specify that they will not buy cartons marked with a Customs stamp.

166. NEMESIS is not available to traders, nor is information on IMEI numbers supplied by traders uploaded and stored on the database,

167. Mr Patterson referred to a visit to LMC on 12 April 2006 at which he discussed the requirement to keep IMEI numbers with effect from July 2006. His note does not go further than that; in particular it does not indicate whether any explanation of the significance of IMEI numbers was given at that time. Nor was there any evidence that any indication was given of the significance of the Customs stamp.

168. In his witness statement Mr Sheridan says that a commercial decision was taken that the cost of staff to make the IMEI checks would outweigh the risks. In cross-examination Mr Leitch said that when he specified that goods should be "subject to inspection and IMEIs" (the example being put to him was a purchase order to Team Mobile dated 21 February 2006) he did so as a matter of course (the order was a template) as a "bit of a get out clause" in case he did not actually want the stock. If that were the case he would simply assert that the IMEIs were no good.

169. We do not consider that the failure of LMC to inspect IMEIs at the material time is something to which weight should be given. It is apparent that, for a trader, the checking of IMEIs would be of little value in assessing the risk of fraud being present in the chains at the time of making the deal itself. It might be of value subsequently to HMRC, but the evidence is that only checks by HMRC themselves were recorded on the NEMESIS database. Traders did not have access to that database. And at all events, the advice given by Mr Patterson was in respect of a period that was to begin after the periods at issue in these appeals.

Credit arrangements

170. To some extent LMC Ltd purchased on credit terms. LMC also offered credit facilities to customers. The terms of the credit offered by LMC were that payment was required on release of the stock. Checks on credit-worthiness of customers were confined to verbal assurances from other traders and from freight forwarders. Mr Leitch earmarked the giving of credit as one of the factors in the growth of the LMC

business. He said that LMC was highly trusted, and would thus be able to obtain credit from suppliers with whom the business had a long-standing relationship.

171. The giving of credit in this way depended on a considerable level of trust. The credit arrangements were informal and without any security. The only documented commercial protection was a retention of title clause in LMC's invoices, which would in our view have been of little value on a sale to a customer outside the UK. Goods were also, however, delivered on "ship on hold" terms, meaning, in theory at least that delivery would be dependent on payment. But this would, in our view, have given little protection in practice in the context of the large amounts of credit given.

172. The significant credit risks that in a normal commercial trade would have been taken, both by LMC and LMC Ltd, and also their suppliers, in the shipping of goods to a foreign customer or freight forwarders without adequate security for payment were not adequately protected against in the arrangements, both in practice and in the contractual documentation.

Contractual documentation

173. There were no written contractual terms of sale between LMC and its customers, and no such terms between LMC Ltd and its suppliers. We find that the terms on which shipment was expressed to be made were confusing. Contractual stipulations appear to have been made without proper appreciation of their significance. At the same time goods appear on occasion to have been shipped "ship on hold", subject to reservation of title and CIF. That is contradictory, as CIF (cost, insurance, freight) means that the seller delivers the goods when they pass the ship's rail in the port of shipment. The risk of loss in the goods passes at the same time from the seller to the buyer, along with other costs after the time of delivery. However, the seller has to provide marine insurance against the buyer's risk of loss or damage to the goods during carriage. The use of CIF, therefore, would cut across reservations of title and ship on hold terms, because the title in the goods would have passed before payment.

Insurance

174. Insurance documentation was provided by LMC for the periods March to June 2006. Insurance was provided by a Dubai-based company, under UAE law. Such a company would not be regulated by the UK authorities. The evidence of Mr Stone provides the reason for the use of a Dubai company: with the introduction of the Insurance Mediation Directive requiring a company to be FSA registered, traders had to find an alternative.

175. Insurance cover was typically provided by the freight forwarders. However, the evidence demonstrates that LMC itself also expended considerable sums (around £200,000) on insurance. Mr Sheridan explained that this was because it was thought that this would provide LMC with more security than that offered by the freight forwarders. But no insurance policies or certificates of insurance were produced. Mr Leitch was unable to assist the Tribunal with details of the insurance cover.

Our conclusions

176. We start by describing, briefly, certain matters that were raised in argument which we have decided should be given no weight.

(1) Evidence from member states outside the UK in relation to customers of LMC Ltd and LMC, including certain admissions that appear to have been made in interview by Freitex GmbH & Co KG that no goods existed in respect of their purported trading with LMC and numerous other UK traders suspected of MTIC fraud.

(2) The fact that LMC and LMC Ltd made all disclosed payments for the transactions through FCIB.

(3) The involvement of Mr Sheridan with the Romanian company, S C Carphone Warehouse Srl.

(4) The proposals by Mr Sheridan to leave Mr Leitch and set up his own mobile phone company, Five Valleys Communications Ltd.

(5) Mr Sheridan's own personal tax affairs, and the establishment of employee benefit trusts for both Mr Leitch and Mr Sheridan.

(6) The circumstances of the striking-out of an appeal by LMC Ltd to this Tribunal in respect of denial of input tax recovery by reference to MTIC fraud.

(7) Evidence relating to a purchase, or purported purchase, by LMC Ltd of Samsung Serene phones in respect of which input tax credit was denied to LMC Ltd, and the appeal was struck out.

Knew?

177. The fundamental questions in this appeal, as is accepted by both parties, are whether Mr Leitch, himself or through his agent Mr Sheridan, knew or should have known that the transactions in question were connected to the fraudulent evasion of VAT. We take these questions in turn, starting with whether Mr Leitch knew.

178. A principal plank of HMRC's argument is that the deal chains were contrived. Mr Rees submitted that no evidence had been presented that this was one overall scheme to defraud, and that accordingly HMRC could not prove that there were "overall coordinators of the fraud" as set out in their closing submissions. From our own review of the deal chains, and from the evidence we have considered, we are quite satisfied that each of the deal chains, whether individually or collectively, in groups if not as a whole, was indeed contrived. We base this conclusion on the patterns of trading evidenced throughout the chains, which we have described, and on the remarkable congruity of the missing traders that appear in chains over a given period (presumably until they have gone "missing"). This analysis of the deal chains, discounting those for which alternative chains have been shown to exist, provides some support for a conclusion that there was a single conspiracy, but even if there were not, we conclude that groups of deal chains involved collective conspiracies, and the apparently seamless switch from one spent missing trader to a new one is evidence of coordination beyond that.

179. We do not accept Mr Rees' submission that the proportion of cancelled deals, even if relatively small, is significant to undermine a conclusion that the deals were contrived. We have described our doubts as to the number of cancelled deals (as opposed to merely cancelled invoices), but even if all 49 of the missing invoices related to cancelled deals, we would conclude that the deals in the deal chains were contrived. In our judgment, even in the context of coordinated or contrived transactions there will inevitably be significant numbers of persons involved, and significant numbers of moving parts generally. Fraud is not immune from implementation problems. Cancelled deals are just as likely, in our view, to occur where fraud is involved as in legitimate transactions. The existence of cancelled deals we therefore regard as neutral.

180. We accept Mr Rees' submission that, absent evidence of money transfers elsewhere, the missing traders are the main beneficiaries of the fraud. But we do not consider them to be the sole beneficiaries. As we have described, the buffers, to a limited extent, and the broker, to a greater extent, also benefit. Those benefits, in our view, cannot be explained by reference to a normal market. In particular a normal market cannot explain the consistent mark-ups achieved in almost all cases, particularly by the buffer traders, including LMC Ltd, nor can it explain the enhanced profits enjoyed by LMC as the broker. As we have described, we do not accept that the cash flow position of a broker would have the effect on the market price payable by a non-UK customer that would have to be the case, were the transaction with that customer to have been independently concluded.

181. Mr Rees argued that HMRC had identified no specific evidence that proves that Mr Leitch knew that his trading was connected to fraud in the 121 deal chains. He submitted that there was no plausible evidence to support a case that Mr Leitch knew there was any fraud in the deal chains. It would, of course be unusual, in a case of this nature, to find evidence that linked a person directly to the fraud. Nevertheless, it is the task of the Tribunal to consider all the circumstances and to determine, on the balance of probabilities, what inferences can properly be drawn

182. We have concluded, taking all the circumstances into account, that Mr Leitch did indeed know that the transactions in question were connected to fraud. We find the evidence of the deal chains themselves compelling in this respect.

183. Firstly, there is the sheer number of deal chains that, it is accepted, have been traced back to defaulting traders or contra-traders. The vast majority of the chains have been traced back in this way. None of LMC's or LMC Ltd's 926 invoices issued between February and July 2006 have been traced back to a legitimate source. This almost universal connection to fraudulent evasion of VAT cannot, in our view, be the result of innocent coincidence.

184. Secondly, we find that the pattern of trading, which with very few exceptions consisted of back to back transactions, in precisely the same quantity of phones throughout, usually on the same day, with remarkably consistent mark-ups down the chain through the buffer traders (including LMC Ltd), and a greater profit being achieved consistently by LMC as the broker, demonstrates coordination and

contrivance that we consider could not have been undertaken without the knowing participation of LMC and LMC Ltd.

185. Thirdly, as our analysis of the deal chains demonstrates, and discounting those for which alternative deal chains have been identified, in numerous deals LMC Ltd obtained its own supply of the phones from a number of different traders who could be linked back along the deal chain to the same missing trader. This cannot be explained as innocent coincidence. In a market as large as the evidence of Mr Leitch and Mr Sheridan would suggest, with hundreds of potential suppliers, it is inconceivable that mere chance could explain how transactions with different suppliers over a given period could be traced back to a single missing trader.

186. Fourthly, in our view, the only reasonable explanation for the Dubai financing is that it was to finance transactions that were connected to a fraudulent scheme. We find that this was the purpose of such financing, and that Mr Leitch and Mr Sheridan were aware of that fact.

187. In our judgment, these observable features of the transactions as a whole could not have arisen by innocent coincidence. In our judgment, Mr Leitch must have known that the supply transactions were connected to these missing traders, and we conclude accordingly that he knew that they were connected to fraud.

188. Mr Leitch was an experienced businessman, who had been engaged over the years in various types of trading in the legitimate grey market. He himself described the market in early 2006 as having developed. He was therefore well aware of the changes. He was also aware, from the numerous formal and informal warnings we have described, of the prevalence of MTIC fraud in the industry.

189. We need to consider the position in February 2006. As a result of the *Bond House* judgment in the ECJ, LMC had recently received a repayment of VAT that had formerly been blocked on the ground that the input tax related to a non-economic activity. We find that Mr Leitch took this as a green light to continue trading in the same manner, in the knowledge that his transactions were connected to fraud; this explains his stated intention to continue trading in spite of the warning given in February 2006 concerning transactions connected with defaulting traders.

190. We accept that the business, largely through Mr Sheridan, sought at this stage to improve its due diligence procedures, although it did not manage to achieve that to any meaningful extent in relation to the transactions in question. This was prompted by the introduction of legislation on joint and several liability, and Notice 726 (which Mr Sheridan read, but Mr Leitch did not). We are satisfied, taking the evidence as a whole, that this was not indicative of a general concern to avoid involvement in VAT fraud, but was instead purely a means to satisfy HMRC that the company was seeking to comply with Notice 726, in letter and spirit.

191. We regard as significant the evidence given by Mr Sheridan concerning his flawed understanding of joint and several liability. It is clear that he understood that the deal chains would be long enough to minimise – on his understanding – the effects

of joint and several liability. Despite assertions to the contrary, we reject any suggestion that the business attempted to reduce the number of traders in a chain by seeking to deal as close to the importer as possible. Both Mr Leitch and Mr Sheridan knew that this was not the case, and their attitude to joint and several liability supports this conclusion.

192. We found Mr Sheridan to be a shrewd and clever individual, who despite playing down his own role – referring to Mr Leitch as "the boss" – was pivotal to the transactions and the way in which the true position could be disguised from HMRC. He was also instrumental in the Dubai financing. As Mr Sheridan was the dealer we are satisfied that, in the context of the deal chains, and on our analysis of them, Mr Sheridan knew that LMC's transactions were connected to fraud. We accept that he had some regard to the due diligence, and followed up on a number of occasions, particularly as regards third party payments. But we have again concluded that, in the context of the knowing involvement in the deal chains, that was intended to satisfy HMRC of compliance with Notice 726 – and the particular references to third party payments that had been made in other contexts – and was not a genuine attempt to avoid becoming connected with VAT fraud.

193. We have considered carefully the notes made by Mr Sheridan, the genuineness of which we have accepted, and the evidence of LMC and LMC Ltd ceasing to trade with certain traders, whether as a consequence of due diligence or other factors, such as gut feeling. However, we reject the submission that this shows that Mr Leitch and Mr Sheridan were doing all they could to avoid being connected to fraud. In our view what this shows is that Mr Sheridan in particular was keenly aware of the guidelines set out by HMRC in Notice 726, and made efforts to ensure that no negative indicators appeared in the way in which the business was conducted. This included in particular seeking to eliminate any evidence of acceptance of third party payments in the chains. In our view, cessations of trading on this account were not to avoid connection to VAT fraud, but to present a plausible picture of LMC's trading practices to HMRC.

194. We do not consider that the rather limited evidence of Mr Leitch having suffered loss, whether within the period in question or outside it, undermines our conclusion. As we have described, the fact that a transaction is contrived for a fraudulent purpose does not guarantee that it would work perfectly. It would still be necessary for a trader to protect himself against the commercial risks that might arise. With a few exceptions which we can discount, it was not suggested that the phones that were the subject of the deals chains did not exist; it is not therefore surprising that steps were taken to insure them. They retained an intrinsic value even though they were the currency of fraud. It is not therefore indicative of the absence of knowledge of fraud that Mr Leitch on occasion suffered loss in his dealings with other traders who were part of the same chains, nor that he sought to protect himself from normal insurable risks.

195. Whilst MTIC fraud may involve cases where the fraud is perpetrated on the basis of entirely fictitious trading, that is not always the case. Where it involves actual trading, the normal commercial processes will, ideally for the fraudster if the

fraud is to remain undetected for a period, be carried out. LMC's trading did, on the surface, have the veneer of ordinary commercial dealing, but on examination it fell far short of what might be expected in a normal commercial business. There were deficiencies not only in the due diligence process, but also in product specification, deal documentation and inspections, and contractual terms. As regards inspections, our conclusion is that, insofar as these were genuinely carried out they performed no discernibly useful function, and were again designed to provide a veneer of ordinary commercial trading. For the most part, although residual risks, such as loss of the goods, continued to exist, we have concluded that the normal commercial risks against which ordinary traders would be expected to protect themselves by proper documentation, were not expected to arise. This supports our conclusion that Mr Leitch and Mr Sheridan knew that the deals were connected to fraud.

196. Mr Rees submitted that the office accommodation, the telephone system that had recently been installed, and the engagement of staff to assist with the trading all militated against a finding that the deals were contrived. We do not agree. We see no conflict between participation in a fraud that requires numerous transactions to be undertaken, and the employment of sufficient staff to carry it out. At the material time LMC were engaged in substantial series of transactions on a daily basis, and clearly would have needed the personnel to carry them through. That is not in our view affected by the fact that the trades were connected to fraud, or that Mr Leitch and Mr Sheridan knew they were so connected. It does, on the other hand, go some way to explaining the reluctance of Mr Leitch, despite his own shortcomings, to recruit a bookkeeper, and his practice of shredding accounting calculations to keep them from the staff concerned.

197. Mr Rees emphasised that Mr Leitch was operating, in relation to the transactions in question as a sole trader, with unlimited liability, and had not sought to hide behind any corporate veil. On that question, while we accept the explanation of the use of LMC as the exporter (to maximise the opportunity to trade whilst minimising the cash flow effect of the VAT repayment system), we have not accepted the reason given by Mr Leitch for continuing to operate LMC Ltd as a buffer trader, selling to LMC. We can only conclude that this was driven by an ultimately misplaced desire to insert a corporate veil into the chain at that level.

198. Mr Rees submitted that it makes no sense that a man such as Mr Leitch would put himself at such personal risk (and indeed LMC Ltd has gone into liquidation and the liquidators are pursuing Mr Leitch in personal bankruptcy) when he could have taken the course adopted by traders to seek the protection of a corporate shield. For that to be the case, argued Mr Rees, when Mr Leitch knew of fraud in the deal chains, would make him a very foolish man. Mr Rees invited us to conclude that Mr Leitch was not a fool, and that this must be taken as showing that he did not know of the fraud.

199. We do not find that Mr Leitch was a fool. But we find that he believed that he would be able to steer clear of trouble, notwithstanding his knowledge of fraud in the deal chains. He had been fortified by his recovery of VAT after *Bond House*, and had taken a considered view on the risk of being subject to joint and several liability,

albeit on a flawed understanding. He would, all things being equal, have sought the protection of limited liability by using LMC Ltd as the exporter, and had planned to do so by applying for the company to go onto monthly returns. When that avenue was closed, we consider it reasonable to infer that a conscious decision was made to continue exporting as a sole trader having assessed the risks, including the risks of the deal chains being discovered to be connected to fraud.

200. There was an exponential growth in LMC's trade, as well as that of LMC Ltd, over this period. This coincided with *Bond House*, Notice 726 and the announcement of the proposals to introduce a reverse charge. Both Mr Leitch and Mr Sheridan were well-acquainted with these developments. We infer that, as HMRC alleged, the opportunity to "make hay as the sun shone" was too good to resist. The considerable efforts, not all of which, with hindsight, can be regarded as successfully implemented, to give the impression of ordinary commercial trading, careful due diligence and an aversion to risk were just that. They were designed to impress and satisfy HMRC. They had no commercial substance.

Should have known?

201. On the assumption that our decision on Mr Leitch's knowledge were different, we turn to consider, in those hypothetical circumstances, whether Mr Leitch, himself or through Mr Sheridan, should have known that the transactions in question were connected to the fraudulent evasion of VAT.

202. We find that each of Mr Leitch and Mr Sheridan should have known. Both were experienced traders in mobile phones. Both were well aware of the risk of mobile phone trading being associated with fraudulent transactions. Both knew that LMC's and LMC Ltd's own transactions had been traced back to defaulting traders. The dramatic increase in the trade, particularly involving exports, at the relevant time could not be explained, as Mr Leitch sought to explain it, by "just becoming busier". A reasonable businessman would have given far greater thought than that to the question, and would not have reached that conclusion. In our view the reasonable businessman would have concluded that it was too good to be true.

203. The reasonable businessman would have asked himself, not only why the trade in mobile phones had increased to such an extent, but why LMC had managed itself to experience such an increase. Such a businessman would not have concluded, as Mr Leitch and Mr Sheridan claimed, that this was due to LMC being an established and trusted business, and one that was prepared – though for the period in question we saw no evidence of this – to give credit. It could not have been due to the IPT website, which had been in operation for some time previously and which had ceased to be a tool directly used by LMC to obtain stock.

204. The reasonable businessman would have been concerned to understand how it was that deals could be done so readily back to back, with consistently high mark ups being obtained by LMC as the exporter. He would have wished to understand why this level of profit remained available even though LMC and LMC Ltd did not manage, apart perhaps on one occasion, to deal with any trader close to the importer.

The reasonable businessman would have wished to understand as well why profits could be obtained on phones that had been imported into the UK only to be exported. He would have questioned why this was being done through trading subject to VAT, when temporary importation could have been organised so as to avoid the imposition of VAT at all.

205. In considering the position in the context of the commercial documentation of LMC, the reasonable businessman would have questioned the nature of the trade, as the absence of proper description of the phones on purchase orders, in particular, and invoices, would have suggested to the reasonable businessman that this was not normal arbitrage trading.

206. The reasonable businessman would have concluded that the financing arrangements with the Dubai-based companies were not on commercial terms and could not reasonably be explained as genuine trade finance.

207. In our view, taking into account all the circumstances, the reasonable businessman's answer to all these questions would have been that the trades were connected to fraud. There is in our view no other reasonable explanation; in particular it is not a reasonable explanation that the transactions in question constituted normal commercial trading in mobile phones. Mr Leitch by contrast ignored all these signs; he was content to carry on trading despite the warnings issued by HMRC. He regarded due diligence as ineffective in identifying connection to fraud, and he was made aware of that very fact, but in spite of that he failed to identify the other indications that the trades might be affected. In our view, therefore, Mr Leitch did not behave as a reasonable businessman in these circumstances. Had he done so he would, in our judgment, have concluded that the only reasonable explanation was that his transactions were connected to fraud.

208. Accordingly we find that, on the assumption that Mr Leitch did not know that the transactions in question were connected to fraudulent evasion of VAT, he should have known that they were so connected.

Decision

209. For the reasons we have given, we dismiss these appeals.

Costs

210. This is a case to which, by direction of the Tribunal, rule 29 of the Value Added Tax Tribunals Rules 1986 has been applied. HMRC indicated in their statement of case that, in the event that the appeals were dismissed, they intended to seek an order that the Appellant pay HMRC's costs. Any such application should be made within 28 days of the date of release of the decision, and any representations of the Appellant in that respect must be made within 28 days of the service of such application on the Appellant.

Application for permission to appeal

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.

ROGER BERNER

TRIBUNAL JUDGE

RELEASE DATE: 29 March 2012