TC02214

Appeal no: LON/2009/0489

Value Added Tax - MTIC transactions involving 19 deals - Sole issue whether Appellant knew or ought to have known of the connection to fraudulent VAT losses - Special significance of "diary" entries, implicitly made by the person who had masterminded 6 of the 19 deals, the diary having been seized by HMRC in the course of a separate criminal investigation - Significance of links between the Appellant and its main supplier – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

GEMINI MEDIA GROUP LIMITED

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

Tribunal: JUDGE HOWARD M. NOWLAN
JOHN G. ROBINSON

Sitting in public at 45 Bedford Square in London on 2-5, 9–11 and 13 July 2012

Hywel Jenkins, counsel, on behalf of the Appellant

Mark Bryant-Heron and Stuart Biggs, counsel, on behalf of the Respondents

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DECISION

Introduction

1. This was a relatively simple Missing Trader or MTIC appeal in which the Appellant conceded that the transactions in which it had participated had been connected to fraudulent VAT losses. The only question for us therefore was whether we considered that HMRC had satisfied the burden of proof in establishing that the Appellant knew or ought to have known that there could be no other reasonable explanation for its transactions than that they were so connected.

2. The dispute involved the Appellant's claim to recover VAT in respect of 19 transactions in which it had exported identical specification Intel CPUs in the months of April, May and the first half of June 2006. The total amount of VAT in dispute was £1,395,587.60.

3. The 19 transactions fell essentially into two categories. The questions for us were whether we believed all the evidence given by the Director and other employee of the Appellant, and whether we considered that the circumstances surrounding each of the two categories of transaction were such that there could be no other explanation for the transactions than that the Appellant must have known of the connection to fraud.

4. The first relevant category comprised 6 transactions, whose common feature was that these 6 deals were all recorded in the pages of a diary, produced in evidence, that had been seized by HMRC in the course of a quite separate criminal investigation. The diary contained the planning details for 650 MTIC chain transactions effected over a 12-month period. The diary details, taking up no more than roughly 3 square inches of hand-written notes for each chain of transactions, gave the identities of each party in the chain, including the Appellant as the "exporter" in the six chains relevant to this Appeal; the unit prices at which each would sell; the number and description of goods, and the points at which payments would be diverted. In all cases relevant to this Appeal the money movements in the chains were circular. These money movements generally commenced with a first payment being made by one of the UK "buffers" in the chain initially paying its supplier, whereupon the payments were then paid to another buffer, then diverted by third party payments so as to flow indirectly to the foreign purchaser from the Appellant and then back indirectly, via the Appellant and its immediate supplier, to the buffer that had made the first payment. This diary information in relation to the 6 transactions with which we were concerned corresponded precisely (with one single exception to which we refer below) to the invoices effecting the relevant transactions and the payment chains, all shown on the Paris server of First Curacao International Bank ("FCIB"), through which all the payments were made by every company in the payment chains.

5. The question for us in relation to these 6 transactions was essentially whether it was remotely credible that the "mastermind" initiating 650 transactions could in some way have ensured its obvious objective, namely certainty that the CPUs and the money would flow in the pre-destined directions, and thus to and from the Appellant, without the Appellant being informed in advance of the role that it was to play, and without us being bound to reach the conclusion that the Appellant must have known that these deals were not negotiated commercially, but had to be connected to VAT frauds.

6. All but two of the remaining 13 transactions, along indeed with 16 out of 17 others that had been effected in the months of February and March 2006 (in relation to which the reclaimed VAT had been paid to the Appellant) had the common feature that the immediate seller to the Appellant was a company with many connections to the Appellant called Grandbyte Computers Limited ("Grandbyte"). Grandbyte had almost invariably made seemingly artificial "mark-ups" on selling to the Appellant, in other words consistent mark-ups in all cases (indeed in all but 2 of its 11 deals, mark-ups of precisely £1 per unit regardless of the number of units sold). HMRC thus contended that Grandbyte's transactions (and indeed all earlier transactions in the relevant chains (all at fixed but much smaller margins) must have been dictated by some other "mastermind", and that each party's profit cannot have resulted from commercial negotiation between genuine traders.

7. The questions for us, therefore, in relation to the transactions in this second category, were whether we accepted the evidence of the two relevant witnesses; whether we accepted the Respondents' contention about the inference to be drawn from fixed margins just mentioned and whether we also concluded that the numerous links between Grandbyte and the Appellant made it realistic that any knowledge on the part of the supplier, as regards connection to fraud, must have been shared with the Appellant.

8. We regret to say that we did not accept, at face value, significant parts of the evidence given by the two relevant witnesses for the Appellant. Aside from this we considered that the facts briefly alluded to in paragraphs 4 and 6 above led us to conclude that there could be no other realistic explanation for the Appellant's participation in the 19 deals than that the Appellant actually knew of the connection to fraudulent VAT losses. We accordingly dismiss the appeal.

The format of the remainder of this decision

9. Since this Appeal involved no dispute in relation to whether the Appellant's transactions were connected to fraud, and since the length of chains and the mark-ups made by earlier buffer companies in those chains would very likely not have been known to the Appellant, we consider that we can deal with many of the basic facts quite shortly. We consider that everything in this Appeal in relation to whether the Appellant knew or ought to have known of the connection to fraud is best analysed by considering the questions that we have posed in paragraphs 5 and 7 above in relation to the two categories of transactions, and by justifying the conclusion that we have already given, namely that we were unable to accept significant parts of the evidence given by the Appellant's two witnesses at face value.

10. With this in mind, the remainder of this Decision will deal with:

- a short initial summary of who gave evidence (paragraphs 11 to 13);
- the background to the relationship between the Appellant and Grandbyte, and the three individuals involved with the two companies (paragraphs 14 to 25);
- an outline summary of the 19 deals (paragraphs 26 to 45);
- the contentions of the Respondents in relation to the various deals (paragraphs 46 to 48);
- the contentions of the Appellant in relation to the various deals (paragraphs 49 to 51);
- all factual conclusions relevant to the relationship between Grandbyte and the Appellant (paragraphs 52 to 69);

- consideration of whether the fixed margins in the chain transactions involving Grandbyte indicate that those transactions were "planned" transactions, and not the product of genuine negotiation and *bona fide* trading (paragraphs 70 and 71);
- our conclusion in relation to whether Grandbyte's role and its links to the Appellant indicate that the Appellant must have had knowledge of connection to fraud in relation to the Grandbyte deals (paragraph 72);
- consideration of the "diary" deals; whether the diary itself was a planning document pre-dating the transactions; whether the Appellant must have known of the connection to fraud, when effecting transactions planned in the diary (paragraphs 73 to 81);
- other damaging features in relation to all deals (paragraphs 82 and 83);
- our justification for doubting certain of the evidence given by the Appellant's two witnesses (paragraph 84), and
- a final summary (paragraphs 85 to 88).

The evidence of the witnesses

11. Evidence was given, on behalf of HMRC, by Officer Sidhu (the case officer); by Officer Mandalia in relation to the analysis of the banking statements of the various participants in the chains with FCIB; by Mr. Eran Milner of Intel; by Dr. Finlay, recently of PWC, and now an independent consultant, as an expert witness in relation to levels of legitimate grey market trading in Intel CPUs and by Mr. Steve Cosslett, an expert witness in relation to "handwriting". Other Witness Statements were produced, including Witness Statements dealing with the circumstances of each fraudulent defaulter at the head of the relevant chains, but these were of very limited relevance once it was conceded by the Appellant that there had in all 19 transactions been fraudulent losses of VAT and that the Appellant's transactions were traced back to such fraudulent losses. All the evidence given on behalf of the Respondents was straightforward and largely factual and we saw no reason to doubt any of it.

12. Evidence was given on behalf of the Appellant by Mr. Steve Jackson ("Mr. Jackson"), and by Mr. Rakesh Solanki ("Rakesh"), to distinguish him from his brother who did not give evidence, namely Mr. Viren Solanki ("Viren"). We regret to say that we did not believe some of the evidence given by the two witnesses for the Appellant, particularly that given by Rakesh. We accept that we need to explain and justify this conclusion, which we will do, particularly in paragraph 84 below.

13. It would not be coherent to summarise the evidence given by each witness in turn. Insofar as evidence was material we will summarise it in the various paragraphs which now follow.

Background information in relation to Grandbyte and the Appellant, and to the various roles of Mr. Jackson, Viren and Rakesh

14. The background history is slightly complex and intertwined. Mr. Jackson and Viren appeared to have been, and indeed to remain, good friends, the friendship dating back to the days when they had worked together which we refer to shortly. As we have indicated, Rakesh and Viren are brothers. Rakesh told us that his family was a close one, and that at the time of the relevant transactions, and indeed ever since, he has usually seen Viren about three times a week.

15. Viren first met Mr. Jackson when Mr. Jackson began to work for Karma International Ltd ("Karma"), a subsidiary in the very substantial CHS Electronics Ltd group, said to be the world's third largest distributor of computer components, in 1998. Viren had been working for Karma himself for about a year prior to Mr. Jackson joining Karma. The two men periodically worked together, Viren having to report to Mr. Jackson, and they became friends.

16. Shortly after joining Karma, Mr. Jackson was promoted and became European project manager in relation to hard drives and monitors. We were told that while Karma was an Authorised Distributor for AMD (the CPU manufacturer that came a fairly distant second to Intel in the CPU manufacturing field), Karma also dealt in grey market trading of Intel CPUs. The legitimate grey market consisted largely of sales of excess stock that computer manufacturers ("OEMs") might have bought in excessive quantities to secure the best Intel discounts, such stock then being sold into the grey market if it was surplus to the manufacturing requirements of the particular OEM.

17. Rakesh had also worked in the IT industry, but initially in a quite different sphere. He had worked, over a 20-year period, in various different areas, as a hardware engineer installing computers; working in a service capacity on a help desk and supporting clients' trading floors, and planning to minimise "millennium bug" issues. In performing these roles he had formed Grandbyte for which he worked, with Grandbyte charging clients for his services, whereupon to reduce PAYE and NIC liabilities, he would take only a small salary from Grandbyte, and take the balance of Grandbyte's profit as dividend.

18. For some reason Mr. Jackson left Karma in 2001 and set up the Appellant, initially with a view to conducting a web development and e-commerce business. This business was not as successful as he had hoped and he therefore started to trade (as he had done at Karma) in CPUs, his objective being eventually to become an Authorised Distributor.

19. Viren was made redundant by Karma about a year after Mr. Jackson had left Karma, in other words in 2002. We were told by Rakesh that when Viren was made redundant, Rakesh *"allowed [Viren] to try and develop business ideas through Grandbyte"*. It seems that, although we are reasonably clear that so far as Rakesh was concerned, Grandbyte was simply his "employing vehicle" to minimise PAYE and NIC liabilities, he did allow Viren to commence some CPU trading in a modest manner. This was consistent with evidence that HMRC produced, showing that various letters had been sent to Grandbyte in 2002 and 2003 informing Grandbyte that on account of MTIC problems in the area in which it was trading, it ought not to deal with some identified company that had been de-registered. We pay relatively little attention to these facts because the VAT records for Grandbyte for some of the months of 2003 that we were shown indicated only very modest trading, if any; many of the letters just appeared to be circulars presumably sent to all companies with certain trading designations, and it was only two letters that mentioned the suggestion that Grandbyte itself had traded with the company that had been de-registered. Rakesh said that he gave little or no attention to the letters, which seemed credible if at this stage, so far as Rakesh was concerned at least, Grandbyte was simply an employing company designed to reduce PAYE and NIC liabilities.

20. VAT return figures that we were shown for Grandbyte seemed to imply only a trivial level of trading of any sort in 2003, modest levels of trading in 2004 (consistent

with modest activity as a buffer company in MTIC trading, though we make it clear that - aside from the reference by Rakesh to the fact that Viren commenced some CPU trading - no evidence whatsoever was given to substantiate MTIC trading). The records demonstrated increasing turnover in 2005, with some moderately significant repayment claims in the period 07/05 to 04/06, and thereafter (from 07/06 onwards) VAT returns revealing modest net VAT liabilities on reasonably significant turnover.

21. Since Grandbyte had essentially been an employing vehicle for Rakesh, designed to reduce PAYE and NIC liabilities, it became redundant when HMRC challenged such schemes and issued its IR 35 notice. Accordingly in 2004 Rakesh ceased to use it as his employing vehicle; he started to work for his clients through a non-controlled company called Jupiter, and Rakesh sold Grandbyte to Viren.

22. Reverting now to Mr. Jackson, and his activity at the Appellant, it appears that his first major deal in CPU trading was an unfortunate disaster. We were not given full details of this deal, but it appeared that HMRC considered it to be an MTIC deal traced to a fraudulent VAT loss, and the Appellant's appeal to recover its input tax was eventually abandoned. This occurred when HMRC produced evidence that the goods sold had in fact been counterfeit Intel CPUs not genuine ones, as obviously the invoice asserted, and when HMRC subsequently won a broadly similar case on the subject of counterfeit goods not corresponding to their invoice description. The resultant failure, in his first major deal, was obviously a major disaster for Mr. Jackson, not in the sense of the Appellant not being paid for the goods sold (because it was paid for the goods and only paid its supplier subsequently) but because it failed to recover the reclaimed VAT of approximately £80,000.

23. When Rakesh left Grandbyte, he worked indirectly for JP Morgan, via Jupiter. When he heard from his brother of the problems that Mr. Jackson was encountering with the counterfeit goods problem in the Appellant, and that Mr. Jackson for some reason (never fully explained to us, though said simply to relate to "financial problems" and difficulties in obtaining banking facilities because his personal credit rating was so low) would have to stand down as a director of the Appellant, Rakesh effectively took over the Appellant, acquired all the shares and became the only director in late October 2005. This he did as soon as he could finish his contract (or rather Jupiter's contract) with JP Morgan. Whilst Mr. Jackson ceased to be a director of the Appellant, he very much remained an employee of the Appellant, and instructed Rakesh as to how to effect wholesale deals in CPUs, and how to effect due diligence etc. Rakesh suggested that his dream, on acquiring the Appellant, was to set up an internet trading business selling computer ancillaries and gadgets. There was some evidence that efforts were made to pursue this plan, but little came of it, and its demise was attributed to HMRC's refusal to refund the VAT that is the subject of this appeal. We were told that Rakesh was now working for BNP Paribas, seemingly having reverted to the type of role he performed initially through Grandbyte and Jupiter.

24. Both before and after Rakesh's acquisition of the Appellant, and the resignation of Mr. Jackson and the appointment of Rakesh to be the Appellant's only director, the Appellant undertook some modest export trading in CPUs in the months of July to November 2005. It opened an account with FCIB in early December 2005, and in February and March 2006 it undertook a considerable number of export deals. In all but one of the nine February deals, the Appellant's supplier was Grandbyte, and in all of the eight March deals, Grandbyte was again the supplier. A company referred to in the hearing as Manhattan was the supplier in the remaining February deal. The

VAT reclaimed in respect of the February and March deals was £466,344.54 and £520,990.76 respectively, and the amounts reclaimed were duly paid on 2 April 2006 and 25 May 2006. By the time HMRC had undertaken their extended verification of the deals effected in the later periods April, May and June 2006, HMRC were out of time to make assessments to seek to recover any of the VAT repaid for the periods February and March 2006.

25. We were also told that in the February to June period, Grandbyte itself made export sales to three of the customers to which the Appellant had also exported CPUs. These three customers were referred to during the hearing as Suyama, Asia Power and Formosa.

An outline summary of the 19 deals

Certain common factors

26. There were the following features to the 19 deals effected in April, May and the first half of June 2006 that are the subject of this Appeal, and it is superfluous to give further detail in relation to the common points other than the following:

- There were various buffer companies between the defaulters and the sale to the Appellant, ranging from 4 buffers in 3 of the "diary" trades, generally 5 buffers, and indeed 7 buffers in relation to deal 15. We will refer in due course to the reason why there were 7 buffers in deal 15, but this is irrelevant at this stage.
- The buffers invariably made margins that seemed inconsistent with commercially negotiated purchases and sales, these margins generally being 5p, 10p or 20p *per* each CPU or unit for the first buffer, gradually increasing to figures like 20p, 30p and 35p as product moved down the chain of buffers with the final buffer selling to the Appellant (Grandbyte in 11 of the transactions) receiving the biggest mark-up, generally of precisely £1. The unit purchase price paid by the Appellant, in order to measure the level of mark-up made by the buffers, was initially in the region of £80, falling somewhat for the deals in June.
- The Appellant's percentage profit varied for the various deals, being close to 7% for the "diary" deals, and in the region of 5% to 6% for the non-"diary" deals.
- The number of CPUs or "units" traded in each deal varied, the lowest number of CPUs traded in any of the deals being 3,150, the highest being 9,135 and the majority being reasonably close to 5,000. These variations had no impact on the £1 margin generally made by Grandbyte.
- The foreign purchaser in each of the "diary" deals was a company in Switzerland referred to as High Level, the purchasers in the other deals being companies referred to as Suyama (located in Singapore), Stanton Tech (located in Malaysia), Opti Tech (located in Mauritius) and ML Liquid Sarl (also located in Switzerland).

The Appellant's profit expectations, and the level of its VAT reclaims in the 19 deals

27. The Appellant's aggregate purchase price for the 19 deals done in April, May and the first half of June was £10,968,762, and its potential profit for those deals, assuming a recovery of the reclaimed VAT, would have been £463,203.80. The VAT reclaimed for the months of April and May was £677,320.88 and £440,062.87

respectively, and the total VAT reclaimed in respect of the 19 deals was £1,395,587.74.

Expert evidence in relation to the assumed level of legitimate grey market trading in Intel CPUs in the period

28. Evidence was given by Dr. Finlay in relation to his estimate of legitimate grey market trading in Intel CPUs in the period. This evidence focused on four issues, two of which we considered to be of little or no significance, and two of which were significant.

29. We accept that Dr. Finlay addressed a marginal deficiency in the invoice description of the goods bought and sold, in that whilst the exact category of CPUs was clearly stated, the invoice description did not clarify the type of packaging, and in particular whether individual boxed CPUs were sold or whether trays, often with 315 CPUs in them, were being sold. In view of the numbers of CPUs traded, we thought that it was reasonably clear that it was CPUs in trays that were sold.

30. Dr. Finlay also gave evidence about the pricing of the transactions, geared to the issue of whether sales at below market value would indicate fraudulent transactions. Again we thought this evidence not to be particularly compelling, in that Dr. Finlay accepted that the pricing of CPUs in the region of £80 was within the legitimate range. Whether the falling value in June was accounted for by expectations that Intel would shortly be bringing out a modified range we do not know, but there was still no compelling indication that any of the pricing was clearly inconsistent with legitimate grey market pricing.

31. The two more significant issues that Dr. Finlay dealt with were his estimate of legitimate grey market sales and export sales from the UK of Intel CPUs in the period, and his estimate of legitimate importations of grey market produce into particular areas. Without indicating the detail, Dr. Finlay's conclusion was that the export sales of this one trader **vastly exceeded** his estimates not of the export sales of just one major UK trader in legitimate grey market product, but his best estimate of total legitimate export sales of Intel CPUs from the UK in the period.

Whether the CPUs traded were genuine Intel CPUs

32. There was minor contention as to whether Intel had indicated that a very small percentage of the CPUs had not actually been sold by Intel at all. This all related to the unique "box numbers", and also the "manufacturing lot" numbers revealed on each inspection report from the freight forwarder of the CPUs traded. The very small number of "suspect" numbers was reduced by the time it emerged that HMRC itself had inserted a few number errors in asking Intel to perform the checks, and we concluded that any remaining trivial number of suspect numbers was more likely to have resulted from similar errors in recording the numbers by the freight forwarder on Inspection Reports, than that any of the CPUs was in fact counterfeit.

33. There then emerged a claim on behalf of the Appellant that since Mr. Milner, on behalf of Intel, had accepted that genuine Intel CPUs were clearly in the UK when they were exported, Dr. Finlay's claim that the number traded by the Appellant exceeded his estimates of legitimate grey market trading had to be wrong. We altogether fail to understand this contention, particularly when the Appellant had actually conceded that all of its transactions were traced to fraudulent trading. We

accept Dr. Finlay's evidence that the volume of trading by the Appellant in the period April to June 2006 vastly exceeded properly calculated estimates of the legitimate UK trading, and particularly export trading of Intel CPUs.

Re-importation of exported CPUs

34. The Respondents gave evidence demonstrating that some of the CPUs exported (identified by box or manufacturing lot numbers) had been identified in other MTIC transactions, following their export by the Appellant. This was not particularly surprising as several of the chains were shown to have been circular. HMRC accepted, however, that none of the CPUs traded by the Appellant appeared to have been traded on an earlier or later occasion by the Appellant itself, so that there was little significance to this evidence.

The pattern of trading by the Appellant

35. Both of the Appellant's witnesses described the way in which they had sought deals in a broadly similar manner. They referred to phoning contacts, whose details they had obtained on CPU trader websites, receiving enquiries in response to their own advertisements as a CPU trader, and interchanges on the MSN messaging system. Following the attendance by both Mr. Jackson and Rakesh at the CeBit exhibition in Hanover at some time in May 2006, they asserted that they followed up contacts that they made at that exhibition. Whilst Rakesh had exchanged e-mails in relation to price negotiation in relation to the largely unsuccessful attempt to set up an internet retail business in components and gadgets, we were told that there had been relatively little e-mail and MSN traffic in negotiating prices in relation to the wholesale CPU trading that occasioned the 19 deals. Mr. Jackson said that the MSN messages no longer existed because the computer had broken down; Rakesh said that he had considered there to be no need to retain the messages, though rather oddly the e-mails relating to price negotiation in relation to the intended retail trading had been retained.

Financing the VAT-gap

36. We will refer to the way in which the Appellant was financed in dealing with the links between Grandbyte and the Appellant below. This information had not been referred to by either witness in their Witness Statements, and only emerged (as we will record below) initially during the cross-examination of Mr. Jackson. Since the Appellant only ever paid its supplier once it had been paid by its customer, finance was essentially only required to fund the "VAT-gap" (in other words the feature that it had exported goods for a lesser price than its purchase price – the export price being exclusive of VAT, and the former inclusive of VAT) pending the hoped-for recovery of VAT.

The Appellant's "due diligence" checks on its suppliers and customers

37. We will not record any of the detail in relation to the "due diligence" undertaken by the Appellant in relation to its suppliers and customers. We note firstly that Lord Justice Moses indicated in *Mobilx v. HMRC* [2010] EWCA Civ 517 that it was inappropriate for Tribunals to give too much consideration to "due diligence" in relation to appellants' immediate counter-parties, and that more attention should be given to all the surrounding circumstances in relation to deals.

38. We put the lack of significance of "due diligence" undertaken by exporters slightly more forcibly than Lord Justice Moses did, in that it is actually fairly evident that the masterminds behind fraudulent chains appeared obviously to conclude, immediately after the ECJ's decision in the *Optigen* case [2006] ECR I-143 in January 2006 (which contained the first indication of what subsequently came to be known as the *Kittel* test) that VAT recoveries would be more likely (and indeed actually "likely") to be achieved by "exporters" and those "despatching" to EU customers, if they could establish that they believed their immediate counter-parties not to be fraudulent, and believed that nothing indicated some connection to a more remote fraud. Accordingly, just as the "diary" deals illustrate, and as is manifestly obvious, the masterminds behind fraudulent and artificial chains always ensured that the immediate suppliers to exporters had an unblemished VAT record (so rendering HMRC's attention to the significance of "Redhill checks" superfluous and if anything a distraction). Similarly the masterminds ensured that goods had passed through a chain of "buffers" each of which, whilst making a generally fictitious looking "margin" (not generally known of course to the exporter), would at least have paid VAT on their fine margin, such that for several steps prior to the supply to the exporter, each supplier could assert that it had not only paid its own net VAT liability, but had equally undertaken some equivalent due diligence in relation to its own supplier.

39. Whilst the Appellant in this Appeal undertook some due diligence, and indeed we accept that nothing divulged to the Appellant was particularly damaging, we still give little attention to the due diligence. This is because we consider that the compelling factors that occasion our decision in this case have nothing to do with the due diligence exercise.

40. So far as due diligence is concerned, we simply record the following two points.

41. Firstly, whenever the credit-rating of a counter-party was said to be "very poor", "poor" or "below average", it was always asserted by both Mr. Jackson and Rakesh in the traditional fashion that this was irrelevant because the trading terms meant that no credit was to be extended to either party, supplier or customer.

42. Secondly Rakesh appeared to be broadly unaware what he was meant to be looking out for, when undertaking due diligence. He repeatedly made the points that he was involved in a steep learning curve, when he joined the Appellant in late October 2005; that he was only involved with broker trading for 9 months, and that while he vaguely knew that MTIC fraud existed in general terms, he thought that it would not affect him or the Appellant if his immediate counter-parties were legitimate traders. He appeared in cross-examination to be unaware why the Appellant listed various requirements, as regards VAT, in its standard-form purchase orders, and unaware why he was undertaking due diligence on customers. He said that exercises such as the Dun & Bradstreet reports on customers were not sought to check on the credit-standing of counter-parties, or indeed on the overall credibility that they were suitable companies with which to deal when dealing in very substantial sums of money, but that the reports were simply obtained to double-check that the companies were "*who they said they were*". Rakesh also asserted that he had only limited time to dedicate to the broker trading activity in wholesale trading of CPUs because his major attention was given to his dream of setting up internet trading in retail sales of components and gadgets. This claim was made notwithstanding the astonishing

turnover in wholesale trading of CPUs and the feature that virtually nothing came of the retail trading aspirations.

43. Our conclusion is that the due diligence exercise was largely a "smoke-screen", but we make it clear that this conclusion is of only marginal significance. We base our decision entirely on other factors.

Some limited failings on the part of HMRC

44. In fairness to the Appellant we record several points in relation to the broker deals that involve some criticism of HMRC's own dealings with the Appellant. Again they are irrelevant to the basis of our decision, but they are worth recording. First, it seemed that the HMRC officer who dealt initially with the Appellant had not given the Appellant the full and clear MTIC warnings that many other MTIC traders regularly received. Relations with that officer appeared to have been good; we were given few specific details of "exchanges", but we got the impression that the officer suggested that the frauds were a general problem, and not something in which the Appellant was thought to be involved itself, or at least (entirely understandably) not something where the Appellant's transactions had been traced to fraudsters. We believe that a copy of Notice 726 was not given to the Appellant until July 2006, after all the contested trades. Furthermore, all the Appellant's VAT reclaims had been paid. Some final document was requested in relation to the March 2006 reclaim, but the February claim was duly paid out on 2 April 2006, and once the remaining detail had been supplied in relation to the March claim, that was also repaid on 25 May 2006. We note that HMRC did write to the Appellant on 19 May 2006, indicating that the April reclaim would be subjected to extended verification (the letter going on to refer to the widespread nature of the MTIC problem, though – rather obviously at that stage - not asserting that the Appellant's trades had been traced to fraud). This letter appeared not to trouble the Appellant, which then undertook a further transaction on 22 May. Whether the Appellant might legitimately have concluded that the 19 May letter was of no great threat to it, when it received £520,990.76 from HMRC in respect of the March claim on 25 May, is debatable.

45. Having summarised those respects in which HMRC's warnings were perhaps less obvious than is often the case, we should finally mention that the Appellant itself had been denied the VAT refund in relation to the sale of counterfeit CPUs, and that it was indeed during late 2005 that the Appellant was dealing with its formal appeal in relation to that matter, and even by mid-2006 the Appeal had not been withdrawn. We will refer to this below.

The contentions on behalf of the Respondents

46. The Respondents' contentions are reflected in the way we deal with the two basic categories of transaction in this case, and the findings of fact that we make in relation to "other damaging factors" below.

47. In short, the contention in relation to the 11 deals where Grandbyte was the supplier was that the fixed margins at which Grandbyte had traded indicated that its transactions had been dictated and pre-planned by some mastermind, and were not the subject of genuine trading. It was specifically asserted that Grandbyte must itself have been a knowing participant in fraudulent trading. It was then contended that on account of all the links between Grandbyte and the Appellant (the most significant of which emerged only during the course of cross-examination) it was inconceivable that

the Appellant would not also have had actual knowledge of the connection of its "Grandbyte deals" to fraud.

48. As regards the "diary" deals, it was asserted that the circularity of the movement of goods, and money, in the diary deals meant that it was vital for the mastermind organising those deals to be certain that the goods would follow their pre-planned route. It was asserted to be inconceivable that the mastermind could take the risk of the Appellant selling goods to the wrong customer, or sourcing any requirement to meet an export deal from a different supplier, so that it had to follow that the Appellant must have been told precisely what it was to do, and so had to be a knowing participant in the fraud in relation to the "diary" deals.

The contentions on behalf of the Appellant

49. It was contended on behalf of the Appellant that it was possible, in the "diary" deals that the Appellant had been contacted by the supplier, then contacted by the foreign purchaser with an attractive purchase offer, such that it was improbable that it would turn down the deal, and that from the perspective of the mastermind this scenario, where indeed the exporter would be an "innocent dupe", was more appealing. For it made any tracing to the "mastermind" much more difficult, if not impossible.

50. It was contended that it was important for us to approach the question of what the Appellant "ought to have known" in relation to the facts, and understanding of MTIC fraud prevalent in 2006, and not with the benefit of hindsight, and in the light of all that is now known about MTIC fraud.

51. It was contended that all the dealings between Grandbyte and the Appellant were entirely commercial, and that the Appellant had done all that it could be expected to do in relation to due diligence.

The connections between Grandbyte and the Appellant

52. We obviously knew of certain links between Grandbyte and the Appellant at the start of the hearing. Other matters emerged during the hearing which put a quite different complexion on the connection between these two companies, and it is essentially to those that we now turn.

53. The links that had always been evident were that:

- the two companies were owned by brothers, who confirmed that they were "close", and that they met approximately 3 times a week;
- the brothers' parents were also directors of Grandbyte;
- Grandbyte had been (one deal apart) the Appellant's monopoly supplier in the deals in February and March 2006 and was the supplier in all but two of the non-"diary" deals out of the presently contentious 19 deals;
- Grandbyte and the Appellant both appeared to have undertaken export deals to the same customers, Grandbyte indeed making an export sale to Suyama on the adjacent day to one when Grandbyte sold to the Appellant and the Appellant on-sold to Suyama; and
- taking the Appellant's February and March customers into account, along with its customers in the 19 deals, both Grandbyte and the Appellant had exported

product not only to Suyama but both had exported to companies referred to as Asia Power and Formosa.

54. The first further material point that emerged during the cross-examination of Mr. Jackson related to the terms of Grandbyte's invoices to the Appellant. These invoices had included two statements that had a bearing on the crucial title and payment terms, one indicating that "Title was retained by Grandbyte until it had been paid in full", and one, seemingly typed deliberately onto the invoices and not just being standard text on printed invoices, saying "TT on inspection". Mr. Jackson's evidence was that these terms were wrong and that Grandbyte had agreed orally that the Appellant should have 24 hours' credit, and that Grandbyte had released the goods to the Appellant, such that *"the goods belonged to us"*, before Grandbyte had been paid. The term about retention of title until "payment in full" was *"obviously a mistake"*. In response to the Respondents' counsel's question as to why Grandbyte extended credit for half a million pounds, without documentation and in conflict with the stated terms, Mr. Jackson's answer was *"It's a lot of money but you have to put it into the context that he's forwarding that amount of credit for 24 hours to somebody who he has known for a very long time"*.

55. Bearing in mind that Grandbyte ostensibly had no idea who the Appellant was intending to sell to, or on what terms (as regards retention of title and protection) the Appellant would sell, we were somewhat surprised initially by this evidence.

56. The next rather more material evidence to emerge resulted from the Respondents' counsel's question of how the Appellant funded the "VAT gap". The answer to this question, posed after a discussion in relation to deals 4 and 5 undertaken on 21 April (in other words one of the earlier of the contested deals), was

> *"Latterly it was accomplished through the retention of profits from previous deals. The initial deals that we did, not in particular the deal that we did here, but prior to that were financed through loans."*

At this point, not unsurprisingly perhaps, we assumed that the initial early period loans had been repaid. When Mr. Jackson was asked at a considerably later point about the Appellant's net cash position, after trading profitably for a considerable period, there was the following exchange, following a number of questions when Mr. Jackson had been unable to say how much cash the Appellant had in its bank account at some point:

> *Q. Let me try this. You mentioned loans?*
> ***A. Yes***
> *Q. How much were the loans?*
> ***A. Again I would need to find the bank statements.***
> *Q. To the nearest £50,000.*
> ***A. I do not recall. Sorry, I would love to help.***
> *Q. Was it a £500 loan; was it a £500,000 loan; was it £100,000. Just ballpark. I am not going to hold you to it.*
> ***A. No, no, okay. Well I think - I do not know. In total I think it was probably about £300,000 or £400,000 I think.***
> *Q. Right. A loan of about £3-400,000?*
> ***A. Yes.***
> *Q. Who from?*
> ***A. From Viren.***

Q. And are you able to produce to this Tribunal documentary evidence of that loan?

A. I do not have it on me, but there is documentary evidence of that loan, I believe.

Q. What was the date of that loan?

A. I do not remember.

Q. Did it pre-date……

A. That would have been around the time 2005/6

Q. Did it pre-date Mr. Rakesh Solanki starting to work for Gemini or was it the same time?

A. Again I am not entirely sure but I believe it was pre-dating.

Q. Why would Viren Solanki loan you £3-400,000 in 2005?

A. Because he wanted to help me."

57. Beyond the Respondents' counsel then emphasising that the dealings between the two companies appeared not to be commercial deals when Grandbyte had loaned the Appellant £3-400,000 and was virtually (at 21 April) the Appellant's monopoly supplier, giving credit for those deals as well, no further information emerged in relation to the loan during Mr. Jackson's testimony.

58. On the following morning, however, Rakesh produced the Debenture document reflecting the loans, as he had been asked to do. The document was a slightly strange document because it appeared to have been largely lifted from some different context in that it created a charge over every conceivable type of asset that the borrower might have, most of which were completely irrelevant. It did however give the lender extreme powers were the loan ever in arrears; it certainly did charge all book debts and any assets that the Appellant might have, and at 12 January 2006, the debenture was for a loan of £631,121.18, on a demand basis, and carrying interest at 2% over Barclays Bank base rate. It emerged that the particular debenture secured the accumulated advances that had been made, and effectively represented a "consolidation" of the various loans. It was signed by Rakesh and Viren on behalf of the two relevant companies, and witnessed by Mr. Jackson.

59. The further information about this very significant loan rendered it markedly less surprising that Grandbyte gave credit to, and released goods to, the Appellant prior to payment, on all of Grandbyte's supplies in the 11 out of the 19 transactions where Grandbyte was the supplier. Whilst the further information further undermined the contention that the Appellant traded independently and commercially, the feature (as the Respondents' counsel contended) that whoever owned the shares in the Appellant, it was Grandbyte that had the principal financial interest in the Appellant (at least until the very substantial loan had been repaid), appeared to be a realistic contention. In other words, the Appellant began to look very much like "a Grandbyte controlled company".

60. Before drawing together conclusions on the relationship between the two companies, we need to mention four further points.

61. We mentioned, towards the end of paragraph 4 above, that there was one occasion on which the actual transactions planned and shown in the diary that we mentioned in that paragraph departed from the pre-set route. This occurred in the deal referred to as Deal 15. Whilst in every other respect the diary routing was followed, Grandbyte, which had not been mentioned as a participant in this deal in the diary, became the immediate seller to the Appellant, making a margin of 75p *per*

CPU, and the Appellant's profit was correspondingly reduced from the pre-planned figure by the same 75p *per* CPU. No changes were made to the other transfer prices and margins in the chain.

62. Whilst other explanations might have been credible but for the other links between Grandbyte and the Appellant, this change to the planned steps appeared to us to indicate either that the Appellant had chosen to push some profit in the direction of Grandbyte, or that at any rate the mastermind behind the "diary" deals would have considered it obvious, if for some reason Grandbyte was to be inserted into the chain (thereby creating a chain of 7 buffers) that it was the Appellant's profit that should be reduced, rather than other changes be made to the chain.

63. A distinct point to mention in relation to the "diary" information was that Grandbyte itself was recorded as the exporter in a separate "diary" deal planned to occur on 27 April 2006, in which the Appellant was in no way involved. Since three of the Appellant's "diary" deals were effected on 25 and 28 April, it seems evident that the mastermind behind the diary was aware of the existence of both companies, and presumably aware (following the conclusions that we reach below in relation to the knowing participant by participants in the "diary" deals) that its fraudulent deals could be arranged through both companies.

64. The next point to mention is that on the deals referred to as Deals 10 and 11, these being non-"diary" deals where Grandbyte was the immediate supplier to the Appellant, both the Appellant and Grandbyte accessed the FCIB website, within minutes of each other, in order to make their respective payments on a computer using the same IP address, in other words either on the same computer or at any rate on computers using the same router. Rakesh was unable to explain this in giving his evidence. His counsel suggested that if the timings on the Paris server happened to be linked to UK time or UK summer time, the payments may have been made when, as occasionally happened, the two brothers were having lunch together. It is accepted that nobody knows to what time zone the FCIB timings on the Paris server relate, and Rakesh could certainly not recall the payments having been made in the manner that the Appellant's counsel suggested to be a possibility.

65. The final point to mention is not so much information as a distinct lack of information. Ostensibly Rakesh became the sole director of the Appellant at the end of October 2005 and he acquired all the shares in this company. We do not know by how much the advance from Grandbyte was actually increased prior to the issue of the debenture on 12 January 2006, but it must have been the case that Rakesh, who ostensibly knew nothing about wholesale trading in CPUs but wanted to set up a retail internet trader in gadgets and general components, bought a company that was substantially in debt to Grandbyte and was still battling with an MTIC dispute with HMRC in relation to the goods that emerged to have been counterfeit. Rakesh suggested that he knew little about MTIC problems (though the company he had acquired had a quite significant MTIC problem). As regards the loan he was vague on the subject of whether it had been repaid or reduced, though probably thought that £50,000 of the loan had been repaid in October 2006, though presumably interest has been accumulating until the present day. We concede that in giving his evidence, Rakesh actually appeared to have forgotten virtually everything, but his evident lack of awareness of the material state of a company that he was buying, ostensibly (referring to his "dream" about retail internet trading in gadgets and components) to perform a function that the company had not performed in the past and that it did not

perform in the next 9 months, was totally inconsistent with the actions of someone genuinely buying a company and being the company's realistic owner.

66. A further significant timing point is as follows. The MTIC dispute that culminated in the Appellant's appeal being dropped when the CPUs traded by Mr. Jackson emerged to have been counterfeit was running at around the time of the change in ownership of the Appellant. The Appellant issued its notice of appeal in late March 2005; HMRC produced their Statement of Case on 4 August 2005, and HMRC's Witness Statements (the documents that were said to produce the fatal evidence about the counterfeit nature of the CPUs) were filed on 14 October 2005. The case was then stayed on 3 November 2006, since another case referred to as *Pexum* was to be taken on appeal and that case would establish whether refunds of input tax were legitimate if counterfeit goods were sold when invoices indicated that genuine Intel CPUs were being sold. Dass Solicitors abandoned their involvement in June 2007, and the Tribunal notified HMRC that the case had been withdrawn in May 2008.

67. It was said that this earlier case became "hopeless" once HMRC produced evidence in relation to the counterfeit nature of the goods. It is, thus, instructive to note that this evidence emerged less than two weeks before Mr. Jackson sold the shares and ceased to be a director, and before Rakesh took over those roles. We were never told precisely why Mr. Jackson ceased to be a director of the company (or indeed why he sold the shares, and we referred to the asserted reasons in paragraph 23 above), but it does seem highly relevant that these changes occurred within two weeks of all involved realising that the Appellant was in considerable financial difficulty, in that it was almost bound not to recover the reclaimed input tax from HMRC in relation to the counterfeit deal, and it thus remained seriously indebted to Grandbyte.

68. We cannot reach a conclusion based just on suspicion, and so do not do so. Our suspicion, based largely on the all the above links between Grandbyte and the Appellant, is that Rakesh (ignorant of broker trading and dreaming of some other trading activity) was inserted, effectively as a nominee, by Grandbyte in the hope that Grandbyte could use the Appellant (as indeed looked to have been fairly successful by the time the February and March repayments had been obtained from HMRC) as a vehicle to undertake joint trading with Grandbyte, and enable Grandbyte to recover what must have appeared in late October 2005 to be a somewhat "bad debt".

69. As we said, we cannot know whether this suspicion is true or not. What we assert, with absolute conviction, is that the connections that we have listed between Grandbyte and the Appellant do lead to the firm conclusion that the Appellant was not trading "independently and commercially" with Grandbyte. The evidence of both witnesses to the effect that it was trading commercially was simply not true. We do not quite know what the truth was, and we do not quite know why there was the swap of shareholders and directors, but we do conclude that the trading between Grandbyte and the Appellant was utterly inter-linked.

Whether the fixed margins at which Grandbyte traded in the deals where it sold to the Appellant indicate that it was not negotiating purchases and sales on a bona fide commercial basis, but acting in accordance with some pre-planned scheme

70. We accept that it has frequently been the case in MTIC chains that the buffer companies that have bought and sold and accounted for VAT on their fine margins will generally have made fictitious-looking margins. This generally attracts little

attention because the focus of MTIC appeals involving the broker companies that export is on whether those companies knew, or ought to have been aware, of the connection of their transactions to fraud, and when there is no reason to suppose that anything known to the exporter's supplier would almost certainly be known as well by the exporter, the feature of the fixed margins in the chain is irrelevant.

71. In this case, however, the Respondents have contended that the fixed margins at which Grandbyte invariably sold in the 11 deals where it sold to the Appellant, must indicate that Grandbyte was acting in conformity with someone's prior plan, and not trading in a genuine and realistic manner. We agree. When we add the two further facts that Grandbyte was also the exporting company in a quite separate "diary" deal, and when Grandbyte appears to have been slotted into the Appellant's deal 15, taking 75p of the Appellant's previously intended profit per unit in relation to that deal, we do reach the conclusion that Grandbyte must have known that its trading was not genuinely negotiated *bona fide* trading, but undertaking artificial transactions in conformity with the pre-planning of some mastermind. In view of the widely known existence of VAT fraud in relation to mobile phones and CPUs, and the feature that every buffer in the chains must have realised that they were being involved in non-genuine trading, we accept HMRC's contention that Grandbyte must have known that its trading constituted a participation (albeit – in the case of the buffer companies - one that HMRC would be unlikely to challenge) in trading traced to fraudulent VAT losses. Nothing else could make sense.

Our conclusion as to whether Grandbyte's role indicates that the Appellant must have had actual knowledge of the connection to fraud in relation to the Grandbyte deals

72. In view of the conclusions that we have reached in paragraphs 69 and 71, we do conclude that it is inconceivable that the Appellant was ignorant of any knowledge on the part of Grandbyte in relation to those deals where the two traded together. It is not simply the feature that during February and March and for 11 of the 13 non-"diary" deals that the Appellant treated Grandbyte as essentially its monopoly supplier. The change of directorship and the transfer of the shares from Mr. Jackson to Rakesh (Viren's brother) at precisely the point when it emerged that the Appellant was in financial trouble and that it was Viren's company Grandbyte, the lender, that stood to lose from the Appellant's problems, all indicate that it was Grandbyte that pulled the strings in relation to the Appellant's trading. Rakesh's regular claims that he never spoke to his brother about the Appellant's deals, when Grandbyte funded the Appellant both generally and furthermore on a deal by deal basis, is simply unbelievable. The two brothers must each have known what either of them knew, and the Appellant must have been aware of the fictitious nature of its trading, and the resultant inevitable connection to VAT fraud.

Consideration of the "diary" deals; whether the diary itself was a planning document pre-dating the transactions; whether the Appellant must have known of the connection to fraud, when effecting transactions planned in the diary

73. There is no need to repeat the information that was contained in the diary, and that we summarised in paragraph 4 above. It is sufficient to say that the diary gave every detail for intended "chain" transactions, including parties, transfer prices, number and description of goods, even foreign participants in circular chains, and points at which payments would be diverted so that the defaulter and the initial buffer

or two would merely be paid their "commissions", and be excluded from the main money movements.

74. The Appellant had sought expert hand-writing evidence to ascertain whether there was any ground for the contention that the initials "GEM", indicating the participation of the Appellant in the diary deals, might have been inserted at some later point, or inserted by a different person, in other words when the traders to either side of the Appellant had managed to dupe the Appellant into buying and selling. The strong indication from the expert witness was that there was no ground for supposing that the Appellant's initials had been written by a different person or in different ink.

75. We might add that to our eyes (naturally with no special expertise in analysing hand-writing) the writing, spacing and thickness of the ink in the entries that referred to the Appellant and the price at which it would sell certainly looked to be entirely consistent with the other chain entries. Some entries in the diaries, generally indicating a date and the words "Fully paid" did seem to be located in different places in the various deal sections, and they did appear (as one would suppose if the entries were only added after payments had been made) to have been inserted after the main entries had been recorded.

76. We certainly conclude that there was no basis for any supposition that the Appellant's initials and transfer prices were inserted at any different time from the other main entries in the diaries.

77. The Appellant's counsel did not seek to suggest that the diary was a document that simply recorded facts after the event. Had such a contention been raised we would have rejected it because:

- the feature that we have just mentioned, namely the seemingly inserted reference to "fully paid" seemed to have been added at a later time; and
- the very feature that one deal, the Appellant's Deal 15, deviated from the planned deal in the diary appears to undermine any suggestion that the diary could just have been recording what had happened.

78. We conclude that the diary was plainly a planning document, in which the entries in the diary indicated the planning by the mastermind as to what was going to happen. The diary was not a post-event record.

79. The Appellant's counsel contended that it was possible that the parties to each side of the Appellant's transactions could have approached the Appellant, one offering CPUs at a particular price, and the other offering to buy CPUs at an attractive price so that the Appellant would be duped into effecting the particular deal. The Respondents contended, as we have indicated, that as it was absolutely vital that neither the product nor the money deviated from the chosen circle, it was inconceivable that the mastermind could have relied on the suggested "duping" feature. The Appellant's counsel had, we accept, made the additional suggestion that if the exporter could have been induced to effect the exactly intended transaction without being implicated in any knowledge of the planning, this would be ideal to the mastermind because it would both enhance the chances of advancing a cogent case for the recovery of the VAT, and render it less likely that information would be divulged to enable the mastermind to be identified.

80. We conclude that it is absolutely inconceivable that any party, designated in the diary to be an exporter, could have been duped into performing its role. We conclude that the exporter must have been told by the mastermind, or by somebody passing on the instructions from the mastermind, what it was required to do. We reach this conclusion for all of the following reasons, beside the point that the conclusion anyway seems manifestly obvious:

- Rakesh, in giving evidence, did say that he thought that each party, to either side of the Appellant's participation in the "diary" deals, had approached it, possibly in response to the Appellant's advertising, but Rakesh was vague about this possible recollection;
- Rakesh certainly said that neither of the Appellant's "diary"-deal counter-parties had said anything along the lines of "I know that High Level (the Swiss purchaser in every one of the "diary" deals) wishes to buy these goods, so sell to it", or "We know that XX can provide to you these goods which we, High Level, wish to buy from you". Inability to fund the VAT-gap, and so inability to export, could have arguably made the first of those indications credible, and one or other such statement might have lent force to any suggestion along the lines that the Appellant was duped into doing the deals, but no such claim was advanced.
- We accept the Respondents' contention that with at least half a million worth of product, and an equivalent amount of cash moving around in each deal, it would have been vital for the diary planning to have been implemented with certainty, and we consider that this indeed makes it virtually inconceivable that the mastermind could have relied on convincing offers and counter-offers being made, and on the Appellant or indeed any exporter being duped into performing its desired role unwittingly.
- Such a suggestion seems wholly unrealistic in relation to the few deals in which the Appellant was involved. Were this the practice, however, it would seem to follow that the mastermind would have contemplated that with 650 deals effected over a one-year period (roughly 2 a day, including Saturdays and Sundays) such a practice would always proceed smoothly. This is fanciful.
- Every party had to log into the FCIB website to make their payments, sometimes on the day following the despatch of the goods, and arrangements appear always to have been made to secure the efficient and swift movement of the money up the chains. Whilst this could have been achieved by phone calls by each payer, and then phone calls by the Appellant to its supplier, centrally-arranged coordination seems manifestly more realistic.
- The very fact that Grandbyte was inserted, as a late-entrant, into the Appellant's Deal 15 (a "diary" deal) must indicate some element of contact between Grandbyte and the Appellant on the one hand and the mastermind on the other hand. Since by this point both companies had been separately involved in earlier "diary" deals, and since it is realistic to expect that the mastermind would at the least have been notified of the change (since somebody obviously had to tell the immediately earlier buffer, namely Trade Corp Ltd, that it should sell to Grandbyte and expect to receive payment from Grandbyte) it seems obvious that the insertion of Grandbyte confirms, rather than undermines, co-ordination between the Appellant and Grandbyte on the one hand and the mastermind on the other.

81. Our conclusion is that it is inconceivable that the Appellant was not aware, when performing its pre-assigned role in the diary deals, that that is what it was doing,

and that that fact involves knowing participation in fraudulent deals and that the Appellant was not simply duped.

Other damaging features in relation to the deals

82. The particular reasons why we dismiss this Appeal are very much geared to the manifest connections between Grandbyte, the self-evident feature that Grandbyte's margins indicated artificial and pre-arranged trading and the evidence that emerged from the diary seized by HMRC. We are also influenced, however, by the fact that we emphasise in the last section of this Decision, namely that we do not believe some of the evidence given by the Appellant's two witnesses. In this present section, we list other features that fortify us in the conclusion that the Appellant knew of the connection to fraud, or that at least as regards some of the points, if it had no actual knowledge, then these factors certainly mean that it ought to have known that there could be no other explanation for the transactions than connection to fraud.

83. Further factors that confirmed us in our conclusion that the Appellant knew of the connection to fraud were as follows:

- Both Mr. Jackson and Rakesh claimed that they ultimately wished to further other trading objectives through the Appellant, but both found it extremely difficult to generate genuine trading opportunities in the relevant areas because of intense market competition, and lack of market presence. When asked why neither considered it odd that there were large potential profits to be made in return effectively for doing nothing on broking Intel CPUs, and when never dealing with an Authorised Distributor, an OEM or other end user, we were unconvinced by the answer that this was the inevitable feature of broker trading.
- When asked why they thought, if they did, that there were bigger profits to be made on exporting product, product that by definition was bound to have first been imported into the United Kingdom, we were unconvinced by their answers. Since the feature of a significant profit repeatedly being made in relation to exports of product that was bound to have first been imported can only sensibly be explained by reference to VAT fraud, fraud known to be commonplace in the relevant trading sectors, any other explanations about demand, exchange differences etc appeared to have been fabricated.
- Whilst we accept that the focus of HMRC's challenge in relation to the Appellant's earlier denial of input tax was more geared to the feature of the product exported being counterfeit, and whilst prior to January 2006, the thrust of HMRC's questioning would have been somewhat different than the challenges after the ECJ's decisions in the cases of *Optigen* and *Kittel*, we are struck by the fact that there is nothing like failing to recover £80,000 in reclaimed input tax to focus the mind on the risks of particular trading patterns. We note the point that in the Appellant's earlier "counterfeit" case the loss was merely of the VAT, so that the customer must still have paid for counterfeit goods without any complaint ever being referred back to the Appellant. This seems to put it beyond doubt that the earlier case was an MTIC fraud in relation to Intel CPUs, where the foreign purchaser did not care whether the goods were genuine or counterfeit. Since the Appellant and Mr. Jackson used several firms of solicitors, all well-versed in MTIC experience, in challenging the earlier refusal of input tax, we consider it unconvincing that Mr. Jackson denied a full understanding of the simple essence, and the risks, of MTIC trading.

- We accept that the Appellant, mindful of Mr. Jackson's experience with counterfeit Intel CPUs, insisted that the freight forwarder should conduct an open box inspection of the CPUs and subject one of the 315 in each tray to electronic testing (so hopefully guarding against a repetition of the purchase of counterfeit goods) but we were still struck that when the Inspection Reports revealed damage to boxes, this was never followed up. We accept that we were told that the damage **might** simply amount to a few scratches on the boxes which would be irrelevant to any purchaser. The more material question, however should have been whether the Appellant confirmed that this was the nature of the damage to the boxes, such that it was then convinced that a genuine purchaser would be untroubled by the slight defect in the packaging. Just ignoring such indications on the Inspection Reports, and asserting that the marks **could** be of no significance appeared to suggest that the Appellant knew that nobody cared about such defects, because the product would just flow round predetermined circles.
- The FCIB evidence confirmed that the "diary" cases, and Deals 10 and 11 involved circular money flows, all effected through FCIB and all the payments being effected in very short time spans. This again suggests that somebody had pre-arranged that all traders in the circle would be ready to log in to the FCIB website in order to make the pre-arranged payments.
- We are struck by the fact that with 19 deals, there was absolutely no written evidence, in the form of e-mails or MSN messages, evidencing terms of trade, negotiation of pricing or anything, particularly when the Appellant had exchanged e-mails in relation to price negotiation in RS's unsuccessful attempt to operate a website dealing with retail sale of gadgets and computer components. We also note that Mr. Jackson accounted for the lack of such written evidence by saying that the computer had broken down, while Rakesh said that he had seen no need to retain the documentation. Whether the few documents in relation to the internet retail trading plan were retained to give some substance to a trade area that may or may not have been remotely genuine we do not know.
- We can accept that brothers might often help each other, and friends might do the same. There was no evidence either way as to whether Viren was a particularly wealthy man, and certainly Grandbyte itself, the lender to the Appellant, was not that substantial a company. The claim therefore that in the early days of the Appellant's trading Grandbyte and Viren thought it appropriate to loan a significant sum of money (perhaps the £300,000 to £400,000 that Mr. Jackson had at one point mentioned) to a friend who was aiming to set up a company that ostensibly would be a competitor to Grandbyte, both periodically exporting to the same foreign customers, seems manifestly implausible.
- The documentation of the deals, not only those involving Grandbyte, was particularly poor. It is commonplace in MTIC trading to hear that a couple of short references on the Invoice summarise the main, and the vital, terms, but to hear that there are two such terms, then to be told that the parties had agreed orally that neither was correct, and then finally to find that assertion credible on account of the general and highly significant funding of the Appellant by Grandbyte, elevates the sloppiness of the documentation to unusual levels.

Reasons for doubting some of the evidence given by the Appellants' witnesses

84. We consider that we should deal with this issue specifically, having left it until we have explained all the relevant facts, so that the following points can be seen in their proper context. The reasons why we doubted the truthfulness of both the Appellant's witnesses were as follows:

- Rakesh periodically asserted that he never discussed the Appellant's deals with his brother, save for arranging for stock purchases in ordinary commercial negotiation. We find this utterly unbelievable. The feature of the funding loans, the credit given on every Grandbyte supply, the near "monopoly" use of Grandbyte as the Appellant's supplier, the feature of both companies exporting to the same foreign buyers, the diversion of the 75p *per* unit profit on Deal 15, and the use of the same IP address in effecting payment through FCIB on deals 10 and 11 all undermine this claim.
- We found Rakesh to be a particularly unsatisfactory witness. He repeatedly said that he could not remember fairly material facts, and there seemed almost to be every indication that he was disinterested in the case.
- We are distinctly doubtful about the fact that the Witness Statements made no mention of very substantial, and highly-relevant loans made to the Appellant from Grandbyte, the fact that this initially emerged (inaccurately) when Mr. Jackson said that later transactions had been financed with earlier VAT repayments and that it was only the earlier trading that had been financed with loans from Grandbyte. When it eventually emerged that in January 2006, the level of the loan was not far short of double the figure that Mr. Jackson had guessed at, and that that level of loan from that particular lender was a decisive fact, the fact that it emerged as it did was highly suspicious.
- We do not purport to know with any clarity why Mr. Jackson ceased to be a director and sold his shares at the end of October 2005, and we do not know why Rakesh, ignorant at the time of broker trading, and repeatedly asserting that he had other aspirations for the company, bought the company and became its sole director. These changes certainly seemed to be geared to the Appellant's financial problem in relation to the refused VAT repayment in relation to the counterfeit CPU problem. Whether he was an inserted "nominee" to undertake joint and effectively "nominee" trading at the direction of the only entity (Grandbyte) likely to benefit in the short or medium term from profitable trading we do not know. We were however absolutely not convinced by anything that we were told in relation to the real reasons for all these changes made at the end of October 2005.
- It is a trivial detail, and it is of course suspicious (and fairly commonplace) in MTIC appeals to hear that records have been stolen, burnt in a fire or lost through a computer breakdown. It is unusual however to be given different explanations by two witnesses for the total absence of written records, both explanations suggesting that at one time there were some written records.
- Mr. Jackson was a sufficiently impressive man, who had manifestly had a fairly senior role in the company Karma, and had therefore genuine experience of CPU trading, and grey market trading in Intel product. This may impact more on the issue of what he ought to have known, rather than, or at least as well as, what he must have known, but we still find it incredible that he believed that the Appellant alone could undertake vastly more trading in Intel CPUs than Dr. Finlay's credible estimates of the vastly lower level of such legitimate trading, and still believe the Appellant's trading to be legitimate and not connected to fraud.

Our overall decision

85. Our decision, arrived at on the balance of probabilities, is that the Appellant did know that its transactions were connected to VAT fraud. Were that conclusion wrong, the numerous connections between the Appellant and Grandbyte, and in particular the role that the Appellant played in relation to the "diary" deals mean that the Appellant had all the indications that should have led it to conclude that its transactions were so connected. The Appeal is accordingly dismissed.

86. We should finally add two important observations, both of which relate to the way in which we have focused principally in this Decision on the two categories of deals, namely the Grandbyte deals and the "diary" deals.

87. The first more important observation is that our conclusion in relation to each category of deal goes to fortify the conclusion in relation to the other deals. If, in other words, we are clear (as we are) that the Appellant must have been knowingly involved as a participant in the "diary" deals, that fact alone makes any protestation highly improbable that it was more likely than not to be an innocent dupe, or a supposedly genuine commercially motivated trader in relation to the other deals. The same point could be expressed the other way round. In other words the highly damaging circumstances in relation to each category of deals is further support that the other category of deals also involves a fraudulent participation in VAT fraud.

88. We have made little reference to the fact that two of the non-"diary" deals involved purchases from the company referred to as Manhattan, and sales in one of those cases to a company referred to as Stanton Tech and in the other to a company referred to as Opti Tech. On the basis of our conclusion that the Appellant must have known that all its other deals could only be explained by their connection to VAT fraud, we find it inconceivable that any different conclusion should apply to these final two deals where the pattern of trading was in fact identical.

Right of Appeal

89. This document contains full findings of fact and the reasons for our 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.

HOWARD M. NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 23 August 2012