# TC02595

**Appeal number: LON/2007/1535**

**VAT – INPUT TAX –** ***HMRC denied input tax claims totalling £6,715,314.73 in respect of 26 transactions of mobile phones – Was there a VAT Loss? – Yes – Was the loss fraudulent? – Yes – Were the Appellants' transactions connected with the fraud? – Yes – Did the Appellants know or should have known that its transactions were connected to fraudulent evasion of VAT? – Yes the Appellants knew – Appeal dismissed.***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**LIBRA TECH LIMITED** **Appellant**
**LIBRA GRAPHICS INTERNATIONAL LIMITED**
**- and -**

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

**TRIBUNAL: JUDGE MICHAEL TILDESLEY OBE**
**HARVEY ADAMS FCA**

**Sitting in public at Royal Courts of Justice The Strand London WC1 on 22 – 24, 26, 29, 30 October, 1-2, November 2012**
**Tribunal reconvened on 19 November 2012 in absence of parties to consider final submissions**

**Timothy Brown counsel instructed by Mills & Reeve, solicitors for the Appellant**

**Jonathan Hall counsel assisted by Michael Newbold and Katherine Duncan counsel instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

### The Appeal

1. The Appellants, Libra Tech Limited ("Libra Tech") and Libra Graphics International Limited ("Libra Graphics") appealed against HMRC decisions denying entitlement to the right to deduct input tax in the total sum of £6,715,314.73 claimed in the VAT quarterly accounting periods 04/06, 05/06 and 06/06.

2. Libra Tech was denied entitlement to the right to deduct £1,822,356.38 in the VAT quarterly accounting period 05/06. Libra Graphics was denied entitlement to the right to deduct £1,338,942.50 in the VAT quarterly accounting period 04/06, £3,250,576.00 in the period 05/06 and £303,439.85 in the period 06/06.

3. The denied input tax related to 26 transactions involving the purchase and sale of mobile telephones. Mr Christian Souter was the sole director of Libra Tech and Libra Graphics at the time of the making of the 26 transactions. For the purposes of this Appeal there were 29 deals, the 12th transaction of Libra Graphics in 05/06 period was broken down into four deals.

4. HMRC's overarching submission was that the disputed transactions of Libra Tech and Libra Graphics were part of an overall MTIC fraud scheme involving a web of companies and chains of transactions where the sole aim was to defraud the public revenue of VAT due to it. The transactions were orchestrated and contrived for such a purpose and had no ordinary commerciality to them.

5. HMRC's primary contention was that Libra Tech and Libra Graphics knew that their transactions were connected with a VAT fraud and they must have known of that connection to have played such an integral role in the fraud. In the alternative Libra Tech and Libra Graphics should have known of the connection of their transactions with a VAT fraud by virtue of the cumulative circumstances presented to each Appellant.

6. The Tribunal is obliged to consider four questions in determining this Appeal, and answer them all in the affirmative if the Appellants are to be denied their right to repayment. The questions were approved in the High Court decision of *Blue Sphere Global Limited v HMRC* [2009] EWHC 1150. The four questions are:

> (1) Was there a VAT loss?
>
> (2) If so was it occasioned by fraud?
>
> (3) If so were the Appellant's transactions connected with such a fraudulent VAT loss?
>
> (4) If so did the Appellant know or should it have known of such a connection?

7. HMRC has the burden of proving on the balance of probabilities its assertion that the disputed transactions were connected with the fraudulent evasion of VAT and the Appellants knew or should have known of their connection. For the purposes of

determining the Appellants' state of knowledge at the relevant time, the Tribunal must examine that of their director, Christian Souter, the controlling mind for the companies.

8. The Appellants' case was that

(1) They accepted that 24 deals can be traced to a tax loss.

(2) HMRC had not proved that in deals 25, 26 and 27 the taxable person purporting to be Teknic was a defaulter as alleged, in which case the Appellant's transactions in these deals were not connected to a tax loss.

(3) HMRC had not proved in deal 29 the alleged contra-trader, ORIL, was not a contra-trader, and, therefore, there was no connection of the Appellant's transaction to a tax loss and a fraud.

(4) They denied that they knew or ought to have known their transactions were connected to fraud.

(5) HMRC's policy of singling out certain parties in a transactions chain tainted by fraud was contrary to the EU law principle of non-discrimination. Alternatively, the Appellants suffered discrimination in the particular circumstances of this Appeal.

9. HMRC pointed out that the Appellants' admissions comprised a typographical error in that they accepted that 25 deals (1-24 & 28) rather the 24 in its final submissions dated 9 November 2012 were traced to a tax loss. The Appellants did not challenge this in their response of 15 November 2012.

**Overview of the Deals**

10. In VAT period 04/06 Libra Graphics entered into six deals, all of which involved the purchase and sale of mobile telephones. Of the six deals:

(1) Two were "broker" deals where the Appellant purchased from a UK based company and sold to a company based in Europe. These deals traced directly to a fraudulent tax loss (Deals 1 and 5). The defaulting traders were the taxable person purporting to be Lewis Davis Productions Limited (Deal 1) and Lewis Davis Productions Limited (Deal 5); and

(2) Four were further "broker" deals traced to one of two contra-traders. (Deals 2-4, & 6). There was no tax loss in the immediate chain in which the Appellant appeared as a broker. However, there were tax losses in a related set of transaction chains in which the contra-traders appeared as brokers. The contra traders were Kwality Trading International PLC (Deals 2-4) and Morganrise Limited (Deal 6).

11. In VAT period 05/06 Libra Graphics entered into 15 deals, all of which involved the purchase and sale of mobile telephones. Of the 15 transactions:

(1) Eight were "broker" deals where the Appellant purchased from a UK based company and sold to a company based in Europe. These deals traced directly to a fraudulent tax loss (deals 8 – 13, 19 and 20). The defaulting trader was Mediawatch 360 Limited; and

(2) Seven were further "broker" deals traced to one of four contra-traders (deals 7, and 14 – 18 and 21). There was no tax loss in the immediate chain in which the Appellant appeared as a broker. However there were tax losses in a related set of transaction chains in which the contra-traders appeared as brokers. The contra-traders were Kwality Trading International PLC (deals 7 14 and 16), Epinx Limited (deals 15 and 17), Jag Tec Limited (deal 18) and A-Z Mobile Accessories Limited (deal 21).

12. Also in VAT period 05/06 Libra Tech entered into six deals, all of which involved the purchase and sale of mobile telephones. Of the six transactions, all were traced back to a defaulting trader. The defaulting traders were the taxable person purporting to be AAA Multilink Limited (deals 22), Mediawatch 360 Limited (deals 23 and 24) and the taxable person purporting to be Teknic Limited (deals 25– 27).

13. In VAT period 06/06 Libra Graphics entered into two transactions, each of which involved the purchase and sale of mobile telephones. Both of the transactions were traced to one of two contra-traders. There was no tax loss in the immediate chains in which the Appellant appeared as broker. However there were tax losses in a related set of transaction chains in which the contra-traders appeared as brokers. The contra-traders were Kwality Trading International PLC (deal 28) and ORIL (deal 29).

14. The Appellants' supplier in every deal chain was Grange Computers. The Appellants' customers were Nova 2000 (deals 1,5, 8-10, 19,20 and 27), Elandour Development (deals 2-4, 7), Spabel Marketing (deal 6), Eurotronics (deals 11-17 and 22-26), CEMSA (deals 18, 21 and 29), and Fremont Europe (deal 28).

**The Evidence**

15. The Tribunal heard evidence (including reading the witness statements) over a period of eight days starting 22 October 2012 and ending 2 November 2012. The parties agreed to make their final submissions in writing due to the incapacity of the Judge who suffered an injury during the course of the proceedings. The Tribunal reconvened on 19 November 2012 in the absence of the parties to consider the final submissions.

16. The Tribunal received evidence in person from the following witnesses for HMRC:

(1) Mrs Heather Ann Arnold who gave evidence on the extended verification exercise undertaken by HMRC on the Appellants' disputed deals.

(2) Mr Andrew Letherby who gave evidence on the integrity of the processes for extracting the data from First Curacao International Bank's **(**FCIB) servers, and on IP addresses.

(3) Mr Roderick Guy Stone who gave evidence on the nature and features of missing trader intra-Community (MTIC) fraud, and the steps taken by HMRC to combat it. Officer Stone also provided evidence on the business affairs of Mr Souter, the Appellants' director, and Joakim Peter Broburg and his associates.

(4) Mr Terence Mendes who gave evidence on his visits to the Appellants in 2003 and 2004.

(5) Mr John Fletcher, a Principal Adviser in KPMG LLP, who was instructed by HMRC to assess the development and structure of the mobile handset industry generally and to analyse the grey market for mobile phone handsets during 2006.

(6) Mr Ian Henderson who gave evidence on his analysis of the FCIB data relating to the disputed deals.

(7) Mrs Melanie Hamilton, Operational Accountant for HMRC, who gave evidence on specific loan agreements entered into by the Appellants.

(8) Mr Nigel Humphries, who gave evidence on the contra-trading schemes associated with the Appellants' deals.

17. Mr Christian Souter gave evidence for the Appellants. Mr Souter was the director of Libra Graphics incorporated in July 2001 and of Libra Technology incorporated in March 2002.

18. The witness statements of Ms Katrina Wheatcroft, Mr Ian Clifford White, Mr Matthew Elms, Mr Ian Michael Simmons, Mr Olabode Ayoola, Ms Deborah Janet Toynbee, Mr Stephen Doyle, Ms Vivien Barbara Parsons, Ms Kym Marna Nevelle Richards, Ms Rebecca Riley, Mr Alan John Ruler, Mr Andrew Siddle, Mr Jason Graham McGuiness, Mr Jonathan Ian Read, Mr David George Maud, Ms Susan Okolo, Mr David Bryan Hancox, Mr Colin Needs, Ms Susan Margaret Tressler, Mr John Patrick Foy, Mr Daniel O'Neill, Ms Susan Elizabeth Hirons, Ms Sarah Jane Allen, Mr Malcolm Orr, Mr Laurence Peter Patay Smith, Mr Peter Alan Cameron-Watson, Mr Dean Maurice Walton, Mr Nikolas Jatin Mody, Ms Lydia Ndoinjeh, Mr Barry Michael Patterson, Mr Michael James Downer, Mr Graham Price and Mr Paul Johnson were admitted in evidence. The witnesses were Officers of HMRC who with the exception of Mr Downer gave evidence on the trading activities of the contra traders and the defaulting traders connected with the Appellants' disputed deals. Mr Downer gave evidence on Operation Ghast, and the freight forwarder, Worldwide Logistics. The bundle of documents admitted in evidence comprised 149 files.

## Applications in the hearing

### *Officer Humphries Second Witness Statement*

19. HMRC requested leave to file and serve the second witness statement of Officer Humphries. According to HMRC, the second witness statement corrected errors made by Officer Humphries in his first witness statement, and updated the information on the various contra-trading schemes, particularly the second one. HMRC submitted that the evidence was highly relevant to the Appeal as it demonstrated the

orchestrated nature of the fraud perpetrated in the disputed deals, HMRC argued that the evidence was capable of being easily understood, and the timing of the service of the evidence did not occasion prejudice to the Appellants. HMRC accepted that Officer Humphries' second witness statement could have been served earlier. A version of it was available in 2011.

20. The Appellants' principal objection to the admission of Officer Humphries' second statement was one of time so that they could give proper consideration to the volume of information which accompanied the second statement. The Appellants acknowledged the validity of HMRC's reasons for requesting leave. The Appellants also accepted that the Officer Humphries' evidence was not critical to the case that they have put forward. The Appellants, however, pointed out that they were entitled to knock down the basis of HMRC's case.

21. The Tribunal admitted Officer Humphries' second witness statement. The Tribunal considered that the admission was justified on the grounds of relevance, and that the prejudice to the Appellants' case as stated in their skeleton was marginal. The Tribunal, however, formed the view that the late service of the statement on the Appellants was unfair particularly as a version of the statement was available in 2011. Given those circumstances the Tribunal decided to permit the Appellants time to examine the new evidence, and ordered HMRC to pay the costs incurred by the Appellants in carrying out this exercise. Following the Tribunal's announcement, the parties agreed to delay the calling of Officer Humphries evidence until 31 October 2012, a period of seven days. HMRC did not object to the costs order under rule 10(1)(b) of Tribunal Procedure Rules 2009.

***Mr Fletcher***

22. The Appellants applied for the Tribunal to exclude the evidence of Mr Fletcher on the ground that it would otherwise be unfair to admit it pursuant to rule 15(2)(b)(iii) of the Tribunal rules 2009. The Appellants referred to a recent decision of the Tribunal in *JDI Trading Ltd v HMRC* [2012] UKFTT 642 (TC) which excluded Mr Fletcher's evidence on what appeared to be three grounds:

(1) The conclusions reached by Mr Fletcher were matters for submission by counsel rather than evidence by an expert witness, and as such did not materially assist the Tribunal in the determination of the appeal (paragraph 63).

(2) KPMG's membership of the Anti-Gray Market Alliance was sufficient to affect the perception of the impartiality of Mr Fletcher's evidence. KPMG being Mr Fletcher's employer (paragraph 80).

(3) The Tribunal was not satisfied in the absence of a statement that Mr Fletcher understands and has complied with Part 35 CPR, that he was aware of his primary duty to the Tribunal as an expert witness (paragraph 85).

23. The Appellants also alluded to the evidence in proceedings before the High Court where KPMG was sued by Arrowhead Capital Finance for breach of its duty of care. The evidence revealed that KPMG had given advice to a company (Dragon Futures) trading in mobile phones on the implementation of a due diligence strategy

to combat the threat posed by HMCE. The Appellants pointed out that Dragon Futures had sold mobile phones to a company called Sunico, which had played a role in this Appeal

24. The Appellants argued the involvement of Mr Fletcher's employer, KPMG, in the anti-grey market alliance and in giving advice to a trader who had been engaged in MTIC deals posed serious questions about inherent conflicts of interest with Mr Fletcher's evidence and its impartiality. On the latter issue the Appellants observed that KPMG was the eleventh largest supplier of service to HM Government. Finally the Appellants agreed with the reasoning of the Tribunal in *JDI Trading Ltd* that Mr Fletcher's evidence was generic and not a proper matter for expert evidence. The Appellants did not pursue Mr Fletcher's compliance with CPR Practice Direction 35 because they believed that this could be overcome by Mr Fletcher making a subsequent statement to that effect. Also the Appellants did not dispute Mr Fletcher's expert status.

25. HMRC made four points on impartiality. The first was that the Appellants' complaints were not about Mr Fletcher personally but about the global organisation for which he worked. In HMRC's view, the Appellants had an uphill struggle to establish that KPMG would be conflicted. Its involvement with *Dragon Futures* demonstrated that KPMG was capable of acting on both sides of the equation. Next the Appellants adduced no evidence about whether Mr Fletcher was involved with KPMG's preparation of the anti-grey market report. HMRC referred to a hearing involving *Amnico* where Mr Fletcher gave evidence that he had no personal involvement with KPMG's activities with the Anti-Grey Market Alliance. Further the fact that KPMG was a large supplier of services to HM Government added nothing to the Appellants' arguments on impartiality. Finally even if the impartiality of Mr Fletcher's evidence was problematical the authorities cited by the Tribunal in *JDI Trading Ltd* were against the Appellants on this point.

26. At paragraph 83 the Tribunal in *JDI Trading Ltd* cited from *Armchair Passenger Transport Ltd v Helical Bar Plc & Anor* [2003] EWHC 367 (QB), where Mr Justice Nelson summarised the current legal position regarding the status of expert evidence:

> "The following principles emerge from these authorities: -
> (i) It is always desirable that an expert should have no actual or apparent interest in the outcome of the proceedings.
> (ii) The existence of such an interest, whether as an employee of one of the parties or otherwise, does not automatically render the evidence of the proposed expert inadmissible. It is the nature and extent of the interest or connection which matters, not the mere fact of the interest or connection.
> (iii) Where the expert has an interest of one kind or another in the outcome of the case, the question of whether he should be permitted to give evidence should be determined as soon as possible in the course of case management.
> (iv) The decision as to whether an expert should be permitted to give evidence in such circumstances is a matter of fact and degree.

> The test of apparent bias is not relevant to the question of whether or not an expert witness should be permitted to give evidence.
> (v) The questions which have to be determined are whether (i) the person has relevant expertise and (ii) he or she is aware of their primary duty to the Court if they give expert evidence, and willing and able, despite the interest or connection with the litigation or a party thereto, to carry out that duty.
> (vi) The Judge will have to weigh the alternative choices open if the expert's evidence is excluded, having regard to the overriding objective of the Civil Procedure Rules.
> (vii) If the expert has an interest which is not sufficient to preclude him from giving evidence the interest may nevertheless affect the weight of his evidence."

27. HMRC moved on to make submissions on the other matters raised in the Appellants' application. HMRC relied on the decision of Sir Andrew Park in *Mobile Export Ltd v Revenue and Customs Commissioners* [2009] EWHC 797(Ch) as authority for the view that HMRC was not required to have Mr Fletcher certify his evidence under CPR Practice Direction 35. In HMRC's view, Sir Andrew Park made it clear that there was an element of relaxation in the rules that applied to the Tribunal, and it would be inappropriate to require a party before a Tribunal to meet certain technical arguments about admissibility.

28. HMRC's final point was that Mr Fletcher's evidence dealt with the existence of a grey market in mobile phones which the Appellants positively relied upon in its Appeal. In those circumstances HMRC wished to meet the Appellants' evidence on this point and in this regard Mr Fletcher's evidence was highly relevant, and contrary to what was said by the Tribunal in *JDI Trading Limited* about the generic nature of his evidence. HMRC referred to the First Tier Tribunal decision in *Atlantic Electronics Ltd* [2011] UKFTT 314 (TC) which was given by Judge Wallace, who had been the Judge in the earlier decision of *Emblaze*. Judge Wallace said in *Atlantic* at paragraph 48:

> "However notwithstanding my own reservations of the value of Mr Fletcher's evidence, I recognise that others may take a different view. This is an important and complex appeal. It is inevitable that the Tribunal will have to consider the grey market if only because the Appellant relies on it. Mr Fletcher's evidence was served in 2009 without any objection until this year. I do not grant the application that it be excluded".

29. The Tribunal refused the Appellants' application to exclude Mr Fletcher's evidence. The Tribunal's starting point was that all relevant evidence should be admitted unless there were compelling reasons to the contrary (Mobile Export 365 Ltd and another v HMRC *[2007] STC 1794)*. In this Appeal, Mr Fletcher's evidence was relevant because it dealt with the grey market in mobile phones which the parties agreed was a salient issue.

30. The Tribunal is a creature of statute and governed by its own procedure rules, which give the Tribunal a margin of flexibility in organising its proceedings provided the overall objective of dealing with cases fairly and justly is met. In this respect,

Tribunals offer a distinctive form of doing justice from the courts[1] and not as rule bound. It follows that the Tribunal was not persuaded that the provisions of CPR Practice Direction 35 applied to Mr Fletcher's evidence[2], and agreed with Sir Andrew Park's view that the rules enable the Tribunal to admit his evidence without having to meet technical arguments about the expert status of the witness.

31. The Tribunal disagrees with the view expressed in *JDI Trading Ltd* that rule 15(1)(c) of Tribunal Rules envisaged that a direction should be sought for permission to adduce expert evidence before serving a statement of an expert witness. The use of the words, *may give a direction* in rule 15(1) go against a construction of a mandatory requirement to seek the Tribunal's leave to adduce expert evidence. The Tribunal considers that the purpose of rule 15(1)(c) is primarily directed at controlling the proliferation of expert witness evidence.

32. The Tribunal also considers that it should be cautious about interfering with a party's choice on the conduct of its case on a salient issue. HMRC have decided in this Appeal to deal with the question of the grey market by calling evidence from Mr Fletcher. The Tribunal's eventual determination on the merits of the evidence may indicate whether HMRC has made the right choice but it is not the Tribunal's role to conduct HMRC's case.

33. The Tribunal doubts the validity of the ruling in *JDI Trading Ltd* that it could not be satisfied that Mr Fletcher was aware of his primary duty to the Tribunal. The ruling was based on Mr Fletcher's failure to comply with CPR 35 Practice Statement. This Tribunal has already questioned the application of that Practice Statement to these proceedings. Further the Tribunal considers it unwise to reach such a conclusion without first giving Mr Fletcher an opportunity to respond. Finally it would appear that the Tribunal in *JDI Trading Ltd* overlooked Mr Fletcher's letter of instruction from HMRC which was referred to in the preface to his witness statement. HMRC's letter of instruction in this Appeal was dated 5 February 2009 and incorporated the following statement addressed to Mr Fletcher:

> "The Civil Procedure Rules, which apply to all civil litigation proceedings in the County Court and High Court do not apply to proceedings before the VAT and Duties Tribunal. That said, it remains the case your overriding obligation is to provide impartial and independent evidence which is uninfluenced by the fact that you are instructed by HMRC to provide evidence for use in the context of litigation".

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[1] See Sir Andrew Leggat's Report of the Review of Tribunals: *Tribunals for Users, One System, One Service (March 2001)*: "They are, however, too much overshadowed by the courts: we want the result of this Review to be a renewed sense amongst tribunals and their staff that they are there to do different things from the courts, and in different ways, but with equal independence. In many respects, it is a more difficult task" (para 1.4).

[2] The Tribunal, however, noted that even though CPR PD 35 did not apply, there was merit in the argument advanced by Judge Mosedale in *Chandanmal v HMRC* [2012] UKFTT 188 (TC) that "there was every advantage to expert witnesses in the Tribunal following CPR Practice Direction 35 and no disadvantage".

34. This Tribunal is satisfied that the contents of the letter of instruction dated 5 February 2009 established in the absence of evidence to the contrary that Mr Fletcher was aware of his primary duty to the Tribunal.

35. The Tribunal was not persuaded that Mr Fletcher's evidence was conflicted by the involvement of his employer KPMG with *Dragon Futures* and the Anti-Grey Market Alliance. The Tribunal noted that KPMG was a global organization with about 145,000 employees worldwide. The Tribunal concluded that the Appellant had failed to establish a connection between KPMG's involvement in these activities and Mr Fletcher's report, and the mere fact of an employer/employee nexus was too remote.

36. The Tribunal, therefore, decided as a preliminary matter that Mr Fletcher's evidence was relevant to the disputed issues in this Appeal and there were no compelling reasons to exclude it. The Tribunal added the caveat that the Appellants were entitled to ask Mr Fletcher questions on conflict of interest, which may alter its preliminary view.

37. After hearing from Mr Fletcher the Tribunal saw no reason to depart from its preliminary decision, in particular the Tribunal placed weight on the following aspects of his evidence:

(1) Mr Fletcher confirmed his understanding of his duty to Tribunal stating

> "To provide a report in line with the instructions received from HMRC and in preparing that report not only to be mindful of those instructions but to prepare a report which is independent and objective and to prepare that report in a way that presents all of the information that is within my knowledge and obviously relevant to my instruction, even where that information could be seen as being unhelpful or running contrary to the case of those instructing me, and where that information changes, such as new information coming to light, to bring that to the attention of the Tribunal as well"[3].

(2) Mr Fletcher stated that he had no involvement with the work done by KPMG for the Anti-Grey Market Alliance. Also he pointed out that the Alliance was concerned with the grey market for, and counterfeiting of, IT equipment, peripherals and software. This grey market was separate to the grey market for mobile phone handsets.

(3) Mr Fletcher did not give advice to *Dragon Futures*, and was unaware that *Dragon Futures* had been a client of KPMG until his testimony before this Tribunal.

(4) Mr Fletcher's witness statement contained nothing that could be interpreted as an opinion on whether the grey market in mobile handsets was good or bad. Further he made no comments that were capable of being

[3] See Transcript Day 4 30.10.2012 pages 14 & 15

interpreted as being pro or anti the grey market or its participants. In fact Mr Fletcher confirmed in evidence the existence of a legal grey market in mobile phones, which was vibrant with many traders[4].

38. The Appellants challenged the weight to be attached to Mr Fletcher's evidence. The Tribunal will deal with this challenge in the body of the decision.

**Applications for Exclusion of Evidence in Final Submissions**

39. The Appellants in their final submission requested the Tribunal to exclude HMRC officers' witness statements which included opinion evidence, or things stated as facts which were actually opinion or otherwise irrelevant. In particular the Appellants referred to the following witnesses:

(1) Officer Stone: in *Chandanmal v HMRC* [2012] UKFTT 188 (TC) the Tribunal excluded significant parts of Officer Stone's generic witness statement on the grey market on the basis that it was opinion.

(2) Officer Arnold's witness statements were littered with matters stated as fact which when examined were no more than her opinions and, therefore, irrelevant.

(3) Officer Downer's evidence had no relevance to the Appellants or any of the parties named in the transactions, alleged contra-transactions or alleged FCIB money chains.

40. HMRC pointed out that the Appellants were not seeking to strike out the entire evidence of those named officers but parts of it which the Appellants have not identified. HMRC contended there was no basis for excluding any of its evidence, particularly after the evidence had now been adduced. In HMRC's view, the questions for the Tribunal in respect of the evidence were relevance and weight.

41. The starting point for the Tribunal's consideration is the status of opinion evidence in law which is covered by section 3 of the Civil Evidence Act 1972 and provides as follows:

> "Admissibility of expert opinion and certain expressions of non-expert opinion.
>
> (1) Subject to any rules of court made in pursuance of this Act, where a person is called as a witness in any civil proceedings, his opinion on any relevant matter on which he is qualified to give expert evidence shall be admissible in evidence.
>
> (2) It is hereby declared that where a person is called as a witness in any civil proceedings, a statement of opinion by him on any relevant matter on which he is not qualified to give expert evidence, if made as a way of conveying relevant facts personally perceived by him, is admissible as evidence of what he perceived.

[4] See Transcript day 4 30.10.2012 page 76.

(3) In this section "relevant matter" includes an issue in the proceedings in question".

42. Section 5 of the 1972 Act defines civil proceedings as including proceedings before any Tribunal in relation to which the strict rules of evidence apply.

43. The Tribunal makes the following observations on section 3 and the *Chandanmal* decision:

(1) There is a category of non-expert opinion evidence which is admissible in law, and covers opinions which are a compendious way of stating the cumulative effect of a number of observations that may have not registered in the witness's mind individually.

(2) The First Tier Tribunal (Tax Chamber) is not a Tribunal to which the strict rules of evidence apply. Rule 15(2)(a) permits the Tribunal to admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom.

(3) The context of the applications in *Chandanmal* was different from that made in this Appeal. *Chandanmal* was a case management hearing where the likelihood of a substantive hearing was at least 12 months in the future. The powers available to the Tribunal in *Chandanmal* were wider than those open to this Tribunal in dealing with post hearing applications for exclusion. Those powers related to the control of the evidence to be presented at the substantive hearing as given under rule 15(1)(a-e) of the Tribunal Rules 2009. Thus, although this Tribunal might disagree with *Chandanmal* regarding the characterisation of specific types of evidence as inadmissible, this Tribunal acknowledges that the decisions reached in *Chandanmal* were justified in accordance with its wider powers and the overall objective of dealing with cases fairly and justly.

44. The Tribunal considers the Appellant's application was inherently contradictory in requesting the exclusion of evidence, which had already been admitted. The argument that evidence is opinion was not a show stopper on the issue of admissibility. Such evidence may be admitted either under section 3 of the 1972 Act or under Tribunal powers in rule 15(2)(a). The Tribunal agrees with HMRC that the evidence complained of by the Appellants was a matter of an assessment of its probative worth rather than its admissibility.

45. The Tribunal's assessment of the probative worth of the statements of Officers Stone, Arnold and Downer is hampered somewhat by the generalized nature of the Appellants' application. The Tribunal makes the following observations in respect of the three witnesses named by the Appellants.

(1) Officer Stone made three witness statements. The Appellants' objection was restricted to his first witness statement which was described as generic. The first witness statement has five sections: Background and Experience, How MTIC Fraud Works, Typical Features of MTIC Fraud, HMRC's Measures against MTIC Fraud, The Effect and Extent of MTIC Fraud. The statement was

factual on HMRC's dealings with MTIC fraud and derived from Officer Stone's extensive experience in this area. Officer Stone was cross-examined on his first witness statement on HMRC's policy on assessing traders caught up in MTIC trades, defaulting traders and the nature of contra-trading. The Tribunal's assessment of Officer Stone's first witness statement was that it was relevant and had some probative worth to the issues in this Appeal by providing an overall background to the nature of MTIC fraud and HMRC's policy in this area. The Appellants' cross examination supported the Tribunal's assessment. The Tribunal, however, acknowledges that the value of the first statement in establishing whether or not the Appellants had the required knowledge or their transactions were connected to fraud was at the margins.

(2) Officer Arnold supplied four witness statements, one statement for each Appellant on the outcomes of the extended verification exercise, and two statements in response to those made by the Appellants' director, Mr Souter. Officer Arnold's evidence carried high probative worth to the issues in this Appeal, in particular, the tracing of the Appellants' disputed deals, and the manner in which the Appellants conducted their business. The Tribunal is in difficulty in answering the Appellants' objections which were phrased in general terms. The Tribunal disregarded those individual comments of Officer Arnold[5] which fell within the Tribunal's remit of making conclusions on the facts.

(3) Officer Downer's evidence concerned Operation Ghast which was an ongoing HMRC criminal investigation of traders engaged in MTIC fraud. The investigation was prompted by the discovery of two CDs which contained details of the contrived nature of the fraud, including the deal chains, and pro-forma documentation and has resulted in the conviction of the ring leaders who have been sentenced to terms of imprisonment. Officer Downer also provided a statement on Worldwide Logistics, a freight forwarder in Holland, whose director Mr Monster has admitted taking care of fictitious consignments. Officer Downer's evidence showed a connection of FAF International, KOM Team SARL and A-Z Mobile Accessories (suppliers and contra trader in the Appellants' deals) to Worldwide Logistics, and Morganrise (a contra-trader) to Operation Ghast. In this respect Officer Downer's evidence went to HMRC's proposition of an overall scheme to defraud public revenue. The Tribunal, however, accepts that Officer Downer's evidence was of minimal probative worth to the issues in this Appeal.

**Amended Statement of Case**

46. The Appellants contended that they were confused by HMRC's case. They referred to Mr Souter's cross examination, where according to the Appellants, HMRC

[5] The individual comments were generally found at the end of the witness statements, for example, paragraph 222 of Witness Statement, Libra Graphics dated 27 February 2009: "I believe all of the above demonstrates an overall scheme to defraud the VAT system to which the Appellant's transactions were connected, and this was something that the Appellant knew or at the very least should have known".

put forward different persons as potential perpetrators of the fraud; T3K, The Broburgs, and the person behind Bulat and Biscay.

47. The Appellants contended that none of the above was pleaded by HMRC in its amended statement of case. The Appellants, therefore, invited the Tribunal to limit consideration of what Mr Souter knew to those matters set out in the statement of case. In support of its invitation the Appellants cited from the judgment of Lord Millett in *Three Rivers District Council v Governor and Company of the Bank of England (No.3)* [2003] 2 AC 1, HL.:

> "183 The rules which govern both pleading and proving a case of fraud are very strict. In *Jonesco v Beard* [1930] AC 298 Lord Buckmaster, with whom the other members of the House concurred, said, at p 300:
>
> > "It has long been the settled practice of the court that the proper method of impeaching a completed judgment on the ground of fraud is by action in which, as in any other action based on fraud, the particulars of the fraud must be exactly given and the allegation established by the strict proof such a charge requires".
>
> 184. It is well established that fraud or dishonesty (and the same must go for the present tort) must be distinctly alleged and as distinctly proved; that it must be sufficiently particularised; and that it is not sufficiently particularised if the facts pleaded are consistent with innocence: see Kerr on Fraud and Mistake 7th ed (1952), p 644; *Davy v Garrett* (1878) 7 Ch 473, 489; *Bullivant v Attorney Genera*; for Victoria [1901] AC196; *Armitage v Nurse* [1998] Ch 241, 256. This means that a plaintiff who alleges dishonesty must plead the facts, matters and circumstances relied on to show that the defendant was dishonest and not merely negligent, and that facts, matters and circumstances which are consistent with negligence do not do so.
>
> 185. It is important to appreciate that there are two principles in play. The first is a matter of pleading. The function of pleadings is to give the party opposite sufficient notice of the case which is being made against him. If the pleader means "dishonestly" or "fraudulently", it may not be enough to say "wilfully" or "recklessly". Such language is equivocal. A similar requirement applies, in my opinion, in a case like the present, but the requirement is satisfied by the present pleadings. It is perfectly clear that the depositors are alleging an intentional tort.
>
> 186. The second principle, which is quite distinct, is that an allegation of fraud or dishonesty must be sufficiently particularised, and that particulars of facts which are consistent with honesty are not sufficient. This is only partly a matter of pleading. It is also a matter of substance. As I have said, the defendant is entitled to know the case he has to meet. But since dishonesty is usually a matter of inference from primary facts, this involves knowing not only that he is alleged to have acted dishonestly, but also the primary facts which will be relied upon at trial to justify the inference. At trial the court will not normally allow proof of primary facts which have not been pleaded, and will not do so in a case of fraud. It is not open to the court to infer dishonesty

> from facts which have not been pleaded, or from facts which have been pleaded but are consistent with honesty. There must be some fact which tilts the balance and justifies an inference of dishonesty, and this fact must be both pleaded and proved".

48. HMRC disputed that it was required to plead precisely what the Appellants knew or did not know. HMRC submitted that the Tribunal should consider all relevant evidence. HMRC could not be expected to know precisely how any fraud worked. In HMRC's view, the Appellants have had sufficient opportunity to understand and meet the evidence called by it. HMRC relied on the decision of Mr Justice Briggs in *Megtian Limited v The Commissioners for HM Revenue & Customs* [2010] EWHC 18 (Ch) who stated that there were likely to be many cases where a participant in a sophisticated fraud was shown to have knowledge that his transaction was connected with a fraud without knowing the precise details of the fraud being perpetrated.

49. The Tribunal considers that HMRC has misunderstood the scope of the Appellants' representations. The Tribunal understands the Appellants' submission to be that the Tribunal should limit its consideration to those matters set out in the amended statement of case. By way of illustration the Appellant has cited three matters raised in HMRC's cross examination which they say painted a more embellished fraud than that portrayed in the statement of case. HMRC have regarded the three matters as the limit of the Appellants' submission and argued that it could not be expected to know precisely how the fraud was instigated.

50. The Tribunal agrees with the thrust of the Appellants' submission that HMRC was required to particularise its case against them. The Tribunal, however, differs from the Appellants about the detail that should be included in the statement of case, In the Tribunal's view, a statement of case is of necessity a summary of the evidence and sets out the essential propositions upon which HMRC relies to establish its case. The Tribunal considers that HMRC is entitled to expand on its case by the exchange of witness statements and opening submissions. In this respect the Tribunal relies on the judgment of Lord Woolf MR in *McPhilemy v. Times Newspapers Ltd* [1999] 3 All ER 775 at 792-3:

> "The need for extensive pleadings including particulars should be reduced by the requirement that witness statements are now exchanged. In the majority of proceedings identification of the documents upon which a party relies, together with copies of that party's witness statements, will make the detail of the nature of the case the other side has to meet obvious. This reduces the need for particulars in order to avoid being taken by surprise. This does not mean that pleadings are now superfluous. Pleadings are still required to mark out the parameters of the case that is being advanced by each party. In particular they are still critical to identify the issues and the extent of the dispute between the parties. What is important is that the pleadings should make clear the general nature of the case of the pleader. This is true both under the old rules and the new rules.
>
> As well as their expense, excessive particulars can achieve directly the opposite result from that which is intended. They can obscure the

> issues rather than providing clarification. In addition, after disclosure and the exchange of witness statements pleadings frequently become of only historic interest."

51. HMRC's amended statement of case included the following contentions:

> (1) The actions of the Appellants formed part of an overall scheme to defraud (paragraph 53).
>
> (2) …. the true nature of the deals can be seen as part of a contrived scheme to defraud the revenue (paragraph 58).
>
> (3) …..it is possible properly for there to be differences in the treatment of traders in the supply chain (paragraph 59).
>
> (4) The transactions formed part of transaction chains in which one or more of the transactions were connected with fraudulent evasion of VAT, and both Appellants …. knew or should have known of that fact.(paragraph 75).

52. HMRC did not depart from the above contentions at the hearing. The amended statement of case was supplemented by 79 witness statements served on various dates between February 2009 and October 2012, with the overwhelming majority served by the middle of 2011. The three matters complained of (T3K, The Broburgs, and the person behind Bulat and Biscay) were covered in the witness statements of Officers Arnold, Stone and Henderson.

53. The Tribunal is satisfied that HMRC had fairly and squarely pleaded its case and the Appellants were clearly aware of the case against them. The Tribunal sees no reason to restrict their consideration to what was set out in the amended statement of case, and agrees with HMRC that it should base its decision on all relevant evidence.

## Consideration

### *The Law*

54. A taxable person is entitled to deduct VAT paid in respect of supplies of goods made to him used for the purposes of his business (art. 168 Council Directive 2006/112/EC (formerly art. 17 Sixth VAT Directive)).

55. The Court of Justice in the joint cases of *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04) established an exception to the right to deduct when the trader knew its transactions were connected to fraud. The Court stated at paragraph 56:

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

56. The Court of Justice concluded at paragraph 59:

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

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

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

58. Under the test in *Kittel* the requisite state of knowledge is that which existed at the time the Appellants entered into the disputed transactions. Further HMRC has to establish the requisite state of knowledge for each of the disputed transactions. This, however, does not mean that the Tribunal must look at each transaction in isolation. The Tribunal is entitled to examine all the available and relevant evidence when determining the Appellant's state of knowledge, otherwise termed as the big picture approach. The authority for this proposition is derived from Lord Justice Moses' endorsement[6] of Mr Justice Christopher Clarke's dicta in Red12 v HMRC [2009] EWHC 2563:

> "109 Examining individual transactions on their merits do not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself,

[6] See *Mobilx para. 83.*

> 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."

59. The Appellants in their Closing Submissions raised two legal arguments. The first was that the refusal of their right to deduct was contrary to the EU law principles of non discrimination/equal treatment. The Tribunal will consider this argument at the end of its deliberation.

60. The second argument was that the decision of the Court of Appeal in *Mobilx* failed to address the issue raised by Lewison J in *Revenue and Customs Commissioners v Livewire Telecom Ltd* [2009] STC 643 in respect of *Kittel v. Belgian State* [2008] STC 1537, that the English translation did not accurately convey the decision of the ECJ with regard to the relationship between the taxpayer claiming input tax on his purchases and the defaulting trader. Lewison J stated at paragraph 61:

> "Overall, it is arguable that these nuances in the English translation convey the impression of a rather less intimate involvement in the fraud than the French text seems to require. However this was not fully argued, so I proceed on the basis that the translation is accurate".

61. The Appellants submitted that the French version supplied the correct interpretation of *Kittel*, namely, the relationship between the taxpayer and defaulter had to be one of counterparties. Thus HMRC was not entitled to deny the Appellants' input tax claim because they did not purchase the mobile phones direct from the defaulting trader. The Appellants stated that the European Commission in its written representations to the ECJ in *Bonik C-285/11* gave support to their understanding of

the French translation of the *Kittel* judgment. Finally the Appellant suggested that the Upper Tribunal in *POWA v HMRC* [2012] UKUT 50, did not consider the amended French legislation which had been enacted purely as a result of the *Kittel* decision when it rejected the apparent differences between the English and French versions of the *Kittel* judgment.

62. HMRC argued that the Tribunal was bound by the decision of the Court of Appeal in *Mobilx* which at paragraph 62 stated that

> "The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase. If the circumstances of that purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that that evasion precedes or follows that purchase. That trader's knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs."

63. In *Powa (Jersey) Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2012] UKUT 50 (TCC) Mr Justice Roth concluded at paragraph 39:

> "…the judgment of the Court of Appeal is clear authority, binding on the Upper Tribunal, that the fact that the trader claiming credit for input tax did not deal directly with a fraudulent trader but was more remote in the chain does not preclude his being denied repayment under the rationale of Kittel ."

64. Mr Justice Newey followed Mr Justice Roth's conclusion on this point *in S & I Electronics PLC v The Commissioners for Her Majesty's Revenue & Customs* [2012] KUT 87 (TCC) at paragraphs 20–30.

65. HMRC also referred to two recent judgments of the Court of Justice which showed that the application of the *Kittel* principle was not confined to transactions immediately connected to the fraud. The first concerned the combined cases of *Mahageben kft* (C80/11) *and Peter David* (C142/ 11). the Court of Justice said at paragraph 45:

> " In those circumstances a taxable person can be refused the benefit of the right to deduct only on the basis of the case law resulting from paragraphs 56 – 61 of Kittel and Rocalta Recycling according to which it must be established, on the basis of objective factors, that the taxable person to whom were supplied the goods or services which served as the basis on which to substantiate his right to deduct knew or ought to have known that the transaction was connected with fraud previously committed by the supplier or another trader at an earlier stage in the transaction".

66. At paragraph 49 The Court of Justice repeated the same formulation that "*the transaction was connected with fraud previously committed by the supplier or another trader at an earlier stage in the transaction"*..

67. The second judgment was in *Gabor Toth* (C324/11). The Court of Justice said at paragraph 53:

> "Having regard to the foregoing considerations, the answer to the fourth question is that, where the tax authority provides specific evidence of the existence of fraud, Directive 2006/112 and the principle of tax neutrality do not preclude the national court from verifying, on the basis of an overall examination of the circumstances of the case, whether the issuer of the invoice carried out the transaction in question himself. However, in a situation such as that at issue in the main proceedings, the right to deduct may be refused only where it is established by the tax authority, on the basis of objective evidence, that the addressee of the invoice knew or should have known that the transaction relied on as a basis for the right to deduct was connected with a fraud committed by the issuer or another operator supplying inputs in the chain of supply".

68. The Tribunal agrees with HMRC's submission that it was bound by both the Court of Appeal judgment in *Mobilx* and the Upper Tribunal decisions in *Powa (Jersey ) Ltd* and *S & I Electronics PLC* in that the *Kittel* judgment was not confined to perpetrator of a fraud and the witting counterparty of such a perpetrator. The Tribunal considers that the recent decisions of the Court of Justice in *Mahageben kft* and *Gabor Toth* removed any doubt in this matter that may have arisen by the different language translations of the *Kittel* decision.

***The Facts***

69. The Appellants' principal case was that they did not know or ought to have known their transactions were connected to fraud. The Appellants questioned whether HMRC had proved the existence of a tax loss in deals 25-27, and the connection of a Libra Graphics transaction in deal 29 with a tax loss.

70. The Tribunal intends to consider the merits of the Appellant's specific issues on tax loss after it has examined HMRC's proposition that the Appellants' transactions were the product of orchestration by fraudsters as part of an overall scheme to defraud the public revenue as opposed to transactions that occurred in an ordinary commercial market.

***Overall Scheme to Defraud***

***Direct Tax Loss Chains***

71. Officer Arnold traced 16 of the disputed deals to a direct tax loss. The Appellant accepted the outcomes of the tracing exercise except for deals 25-27 which will be considered later.

72. The tax loss in the remaining deals (1,5, 8-13, 19, 20, 22-24) was occasioned by The Taxable Person Purporting to be Lewis Davis Productions, Lewis Davis Productions, MediaWatch 360 and The Taxable Person Purporting to be AAA Multilink. The Tribunal is satisfied that the actions of these traders resulting in the tax loss were fraudulent.

73. In April 2006 Lewis Davis Productions started trading in the mobile phone sector which was entirely different from that declared in its registration documents in February 2006. In a space of two months Lewis Davis Productions purported to conduct deals in the region of £10 million. The company submitted no VAT returns and company accounts. Lewis Davis Productions was now in liquidation with a tax loss of £1,770,978.

74. In relation to deal 1 HMRC was satisfied that the tax loss was occasioned by a Taxable Person Purporting to be Lewis Davis Productions. The invoice for this deal was in a different type font, having a different layout and detailing a different registered address from the invoices for Lewis David Productions. The fact that the VAT registration of Lewis Davis Productions, a defaulting trader, had been hijacked by another trader supported the fraudulent nature of the deal. The Appellants criticised HMRC for accepting the word of an alleged fraudster from Lewis Davis Productions in deciding that the registration number had been hijacked. The Appellants, however, did not challenge Officer Arnold's tracing of deal one to a fraudulent tax loss.

75. HMRC discovered that Mediawatch 360 had been engaged in a very large level of trading for a newly registered company. HMRC's database showed that Mediawatch incurred output tax in excess of £10 million in the period of 3 April 2006 to 30 May 2006. Despite a number of visits and repeated correspondence, Mediawatch's first and only VAT return was submitted in August 2007. Mediawatch had provided no documents to support the trading it purported to have conducted. Rather HMRC's assessments have been raised on the basis of the material obtained from other traders. Mediawatch was also involved in third party payments. Finally the director of Mediawatch 360 had been disqualified as a director for a period of 14 years because he caused or allowed Mediawatch to be involved in MTIC fraud.

76. Assessments in excess of £8 million have been raised against the Taxable Person Purporting to be AAA Multilink which have not been paid. The use of a hijacked VAT registration number was fraudulent.

77. The Tribunal is satisfied that the length and composition of the direct tax deal chains reinforced HMRC's proposition of an overall scheme to defraud the public revenue. All the chains had at least three traders between the Appellants and the defaulting trader with three deals having five intervening traders. In each deal Grange Computers was the supplier of mobile phones to the Appellants. Xchange Communications (12 times), Starmill UK (10 times) and Headcom (7 times) appeared regularly in the chains. Finally traders played specific roles in the chains. Xchange Communications was the purchaser from a defaulting or hijacked trader. Stardex, Starmill and Headcom were the suppliers to Grange Computers.

78. The buffer traders prior to Grange Computers applied consistent mark ups with round number amounts (generally £0.50, £1, £1.50 & £2). The traders that appeared early in the three deal chains of five members had even smaller mark ups of £0.15 and £0.20. The mark ups for Grange Computers and the Appellants were considerably larger than the other traders in the chains. In the direct tax chains the mark ups for

Grange Computer ranged from £1 to £8, whilst that for the Appellants was £6.80 to £14. Finally in deals 1, and 8 to 13 the freight forwarders released the goods without written instructions which was contrary to the purported business terms for the traders in those deal chains.[7]

79. Mr Fletcher found it hard to understand the rational commercial activity behind longer deal chains. The longer the chain, the smaller the available margins for each individual trader. Mr Fletcher considered there were two circumstances in which a longer deal chain might be justified. The intermediaries were demonstrably adding value to the transaction or that a trader may find itself in a long deal chain on the first occasion that a deal was entered into. The Appellants did not assert that the two justifications identified by Mr Fletcher for the long deal chains applied to the direct tax chains in this Appeal. The Appellants offered no explanation for the length and composition for these chains. The Appellants simply stated that they were unaware of the existence of them. The Appellants only knew of the identity of their supplier and customer.

80. The Tribunal agrees with Mr Fletcher's conclusion. The presence of a large number of parties suggested that the structure of long deal chains was in place for another reason unconnected with profit maximisation. Mr Stone's evidence on this point provides in the Tribunal's view the most probable explanation for the long deal chains, namely that, buffer traders acted as conduits in holding and transferring title to the consignments concerned, which served to disguise the overall nature of the fraud by putting distance between the missing and broker traders.

81. The Tribunal is satisfied that the fraudulent nature of the direct chains was demonstrated by its findings on the following matters:

(1) The chains for deals 1, 5, 8-13, 19, 20, 22-24 were all traced to a direct tax loss. The position regarding deals 25-27 will be considered later.

(2) Each loss was occasioned by the fraudulent activities of a missing trader.

(3) The contrived nature of each chain including deals 25 – 27 in respect of length and composition.

(4) The use of consistent mark ups in small rounded numbers by the buffer traders, and the flouting of business terms in deals 1, and 8 to 13.

(5) The structure of long deal chains served to disguise the overall nature of the fraud by putting distance between the missing and broker trader.

**The Contra Trades**

82. The Appellants' deals 2, 3, 4, 6, 7, 14-18, 21 and 28-29 were traced to six contra traders (Kwality Trading International, Morganrise, Epinx (also known as Libra Fair Trades), Jag Tec, A-Z Mobile Accessories and ORIL). The Appellants did not challenge HMRC's tracing exercise in respect of the contra-traders except ORIL in

[7] The evidence on mark ups and release of goods without instructions are summarised in HMRC's core bundle B/tabs D & H

deal 29. In this instance the Appellants argued that ORIL did not have the characteristics of a contra-trader, a point which will be examined later by the Tribunal.

83. HMRC established that the six contra traders were involved in three schemes of contra-trading:

(1) Scheme 1 involving contra-trading by A – Z Mobile Accessories, ORIL, Jag Tec and two additional contra-traders (Red House International Limited and Starmill International Limited).

(2) Scheme 2 involving A – Z Mobile Accessories, Epinx, Kwality and other contra-traders (including BTS Specialised Equipment Limited, Highfield Distribution International Limited, Intertrade Worldwide Limited, Prime Telecom Limited, S & R International Limited and Waterfire Limited);

(3) Scheme 3 involving Morganrise.

84. In scheme 1 the mobile phones originated with Kom Team, a French trader, which had been the subject of investigations by French authorities. The authorities established that Kom Team did not have operational, storage facilities, assets and staff and had been unable to justify sales transactions made with traders including A – Z, Red House and Starmill. Kom Team sold the goods to the five contra-traders. After which the goods went to a group of nine buffer traders and then onto a group of 32 UK broker traders.

85. The 32 broker traders exported the goods to five EU traders. With the exception of three transactions (Communications World selling to Emisfer, and Stardex selling to Navigo and Mobile Express), all deals involved goods sold to just two EU traders. Those traders were CEMSA (a Spanish company) and Evolution (a French company). This outcome was maintained regardless of which UK traders the goods passed through.

86. HMRC further traced the goods from CEMSA and Evolution to a common customer of both, Vundera SA of Latvia which had no business establishment in Latvia. Its director from 3 February 2006 was a resident of Spain.

87. The outcomes of this scheme were that most of the goods originating with a single French supplier, Kom Team, were sold to a single Latvian customer, Vundera, via more than 40 different traders both inside and outside the UK. HMRC identified that the EU customers paid more than £8 million by purchasing goods from the UK brokers rather than direct from Kom Team.

88. HMRC adduced evidence that A – Z Mobile Accessories and Jag-Tec operated as dishonest contra-traders, which the Appellants did not dispute. Essentially A – Z Mobile Accessories was found to have conducted 167 broker transactions in periods 05/06 and 08/06, of which all but two were traced to a fraudulent tax loss. A – Z Mobile Accessories disguised the tax losses by offsetting the input tax claim in the broker transactions against the output tax purportedly payable on its sales in scheme 1. The net effect was that despite having outputs of £425 million in periods 05/06 and

08/06, A – Z Mobile Accessories remitted a total of £83,000 in VAT to HMRC. Likewise in respect of Jag Tec, its 37 broker deals in period 06/06 were all traced to a fraudulent tax loss. The amount payable in VAT for period 06/06 was £4,000 despite outputs of £110 million.

89. HMRC also demonstrated that the Cypriot trader RCCI High Tech acted as both a supplier to Kom Team and a customer of the majority of the goods from the contra traders in their broker chains which emphasised the connection between the acquisition and broker transactions of the contra traders and the overall fraudulent nature of the transactions in scheme 1.

90. The tax losses connected with the fraudulent activities of A – Z Mobile Accessories and Jag-Tec were those incurred by Okeda Limited, Eutex Limited, UK Communications Ltd, D9 Connections Limited, Phone City and The Taxable Person Purporting to be Wade Tech Ltd.[8]

91. The Appellant, Libra Graphics, operated as a UK broker in scheme 1 in three of the disputed deals 18, 21 and 29, which were the only deals in periods 04/06 to 06/06 in which goods were supplied by the Appellants to CEMSA.

92. Scheme 2 involved 11 contra traders. The mobile phones started with the trader Chugwater which were then passed through a small set of Tier 2 EU suppliers to Tier 1 EU suppliers who sold the phones to the contra traders in the UK. The phones then went through nine UK buffers and 36 UK brokers before being sold to an almost identical set of Tier 1 EU customers (nine of the traders identified as Tier 1 suppliers were also Tier 1 customers) and then to an identical set of Tier 2 EU customers (all six traders identified as Tier 2 suppliers were also Tier 2 customers). The mobile phones finally ended up being sold to a single customer, Quay SRO, a trader operated, in common with Chugwater, by Vladimir Karlinsky. In short there was circularity of mobile phones under scheme 2. Also the increased cost to the EU customers was in excess of £2.4 million by purchasing the goods from UK brokers rather than going direct to the EU supplier.

93. A – Z Mobile Accessories, Epinx, and Kwality were the three contra traders which had dealings with the Appellants under scheme 2. The Tribunal has already dealt with the evidence on A – Z mobile Accessories as a dishonest contra-trader. Epinx transacted 77 broker deals in periods 03/06 and 06/06, 70 of which have been traced directly to fraudulent tax losses. Epinx disguised the tax losses by offsetting the input tax claim in the broker transactions against the output tax purportedly payable on its sales in scheme 2. The net effect was that despite having outputs of £290 million in periods 03/06 and 06/06, Epinx remitted a total £7,670 in VAT to HMRC in 03/06 and submitted a repayment claim of almost £19,000 in 06/06. Similarly Kwaility undertook 64 broker transactions in 04/06 and 07/06 periods, of which 63

[8] HMRC sets out in the fraudulent nature of the tax losses in paragraphs 5.156 – 5.165 & 5.199 – 5.208.9 of its Opening Submissions dated 8.10.12, which were not disputed by the Appellants, and adopted by the Tribunal.

have been traced directly to tax losses. Kwaility's VAT liability for these two periods was just £4,000 for total outputs of £137 million.

94. The tax losses connected with the fraudulent activities of Epinx, and Kwality were those incurred by The Taxable Person Purporting to be Eutex Limited, The Taxable Person Purporting to be R & M Electrical Wholesalers Ltd, The Taxable Person Purporting to be the Export Company Limited, Prestige 29 UK limited, Zenith Sports UK Limited and The Taxable Person Purporting to be 1st 4 Reports [9].

95. The Appellant, Libra Graphics operated as a UK broker in scheme 2 in nine of the disputed deals, 2, 3, 4, 7, 14, 15, 16, 17, and 28. These deals represented the only deals in the periods 04/06 to 06/06 in which Libra Graphics supplied Elandour and Fremont.

96. Scheme 3 involved the acquisition of mobile phones by Morganrise from Nordic SR. Morganrise then sold the mobile phones through a series of buffers to broker traders which then retailed the mobile phones to three EU traders, Taglemeer, Derastec, and Spabel Marketing.

97. The contrived nature of scheme 3 was demonstrated from the decision of EU traders to purchase goods from UK suppliers at a higher price rather than from EU suppliers at a cheaper price. HMRC also identified circularity of goods in certain transactions. Bulat 16 paid £118,170.00 to re-purchase goods which they had originally sold to Morganrise. The fraudulent character of the scheme was reinforced by the fact that three key players have now gone missing, Derastec and Spabel Marketing in Spain, and Nordic SRL in Italy.

98. The Appellants did not challenge the description of Morganrise as a dishonest contra-trader. In periods 03/06 and 05/06 Morganrise entered into 114 broker transactions, all of which have been traced back direct to fraudulent tax losses. The input tax claim of £60 million on these broker deals was partly offset by the output tax liability of £42 million on the acquisition deals.

99. The tax losses connected with the fraudulent activities of Morganrise were those incurred by The Taxable Person Purporting to be Wildtower Limited, The Taxable Person Purporting to be N & M Traders Limited and Premiere Insurance Services Limited[10].

100. The Appellant, Libra Graphics operated as a UK broker in scheme 3 in disputed deal 6. This deal represented the only deal in the periods 04/06 to 06/06 in which Libra Graphics supplied Spabel Marketing.

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[9] HMRC sets out in the fraudulent nature of the tax losses in paragraphs 5.41 – 5.48 & 5.120 – 5.125 of its Opening Submissions dated 8.10.12, which were not disputed by the Appellants, and adopted by the Tribunal.

[10] HMRC sets out in the fraudulent nature of the tax losses in paragraphs 5.80 – 5.85 of its Opening Submissions dated 8.10.12, which were not disputed by the Appellants, and adopted by the Tribunal.

101. The Appellant's mark ups in the three contra-trade schemes were considerably higher than that achieved by the contra-traders whose mark ups were in small amounts and round numbers. The freight forwarders in deals 7, 15,16 and 17 released goods for export even though their clients further down the chains had not provided the requisite instructions in writing[11]. In common with the direct tax loss chains Grange Computers was the supplier of mobile phones to the Appellants in each of the disputed deals connected with the three contra-trading schemes.

102. The Tribunal finds in relation to the three schemes that

(1) Overall each scheme showed the same pattern with the mobile phones passing from a distinct small group of EU suppliers to a distinct small group of EU customers. In scheme 2 the two groups were almost identical. The destinations in each scheme were maintained even after the mobile phones had passed through a larger number of different UK traders.

(2) There was no commercial reason for the mobile phones to be imported into the UK. The EU customers consistently paid unnecessarily high prices to UK suppliers for mobile phones which were available more cheaply in mainland Europe.

(3) Circularity of goods was a prevalent feature throughout the three schemes.

(4) The schemes were associated with substantial tax losses

(5) The tax losses were disguised by the dishonest activities of the contra-traders which offset the input tax claims in their broker transactions with the output tax liability in their acquisition transactions.

***Money Flows***

103. Officer Henderson gave evidence on the money flows for the Appellants' disputed deals. His analysis involved the tracing of the movement of monies in the Appellants' chains of purchases and sales identified by Officer Arnold from the deal documentation. Officer Henderson's analysis was derived from his examination of the First Curacao International Bank's (FCIB) records which were called Bankmaster Plus and the Datastore.

104. Bankmaster Plus gave a print out of the customer account for each trader banking with FCIB. During the course of his investigation Officer Henderson was given access to the information held on the Paris FCIB server which supplemented the data provided by the trader's customer account. The narrative on the Paris server identified the payer of the funds, the date of the payment, the timing of the payment, the address of the payee, in which country the payee was located, the account holder's secret password and from 1 May 2006 the IP address from which the payment was made.

[11] The evidence on mark ups and release of goods without instructions are summarised in HMRC's core bundle B/tabs D & H

105. Datastore gave details of the documents presented by the account holder in support of its application to open a FCIB current account.

106. HMRC also adduced evidence from Officer Letherby in respect of the methodology of the data capture from the FCIB servers. The Appellants did not challenge the methodology and the integrity of the data captured[12].

107. HMRC relied on Officer Henderson's analysis to demonstrate the highly contrived and orchestrated nature of the Appellants' deal chains which reinforced its primary contention that the disputed transactions were part of an overall scheme to defraud public revenue.

108. The Appellants pointed out that certain deals did not show circularity of funds, and that, in any event, Mr Souter knew nothing of the movements of monies outside the Appellants' immediate transactions. The Appellants contended that the Tribunal should be wary of Officer Henderson's evidence which purported to show circularity of monies because:

(1) It was not possible to reconcile invoice amounts.

(2) Officer Henderson just followed the money with no regard to dates on which the transactions took place.

(3) Even where circularity was alleged, the chains were broken by money being transferred out of date sequence.

109. The Tribunal at this juncture is not concerned with what Mr Souter knew about the movements of money but about whether Officer Henderson's evidence supported the primary contention of an overall scheme to defraud public revenue. In this respect the Tribunal observes that the Appellants' challenge was limited to the issue of circularity. The Appellants did not dispute equally important aspects of Officer Henderson's evidence which demonstrated the fraudulent nature of the deal chains.

110. The Tribunal finds that Officer Henderson's analysis revealed that there were 21 traders from outside the UK which were involved in the money movements and not present in the invoice chains[13]. The participation of these 21 traders from outside the UK appeared to serve no commercial purpose, particularly as their monies were funding the acquisition of mobile phones in and their rapid despatch from the UK.

111. Officer Henderson's analysis also showed that these 21 traders were organised into distinct cells in relation to the Appellant's direct tax loss chains, and the three contra-schemes identified by Officer Humphries. Thus:

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[12] See Transcript Day 2 26.10.12 p108, Appellant's counsel did not challenge HMRC's observation on the integrity of the data.

[13] See the summary in Core Bundle Tab F

(1) Bulat 16V, Poland (12)[14], Biscay Business , Spain (13), Euro Councel et Development, France (7), Arta Network, France (10), Derastec, Spain (7), Acquired Solutions, Portugal (2), MultiMode Marketing, Spain (3), Quebec Inc, Canada (4), and Ixcel SA, Luxembourg, (4) formed the distinct cell of traders in the direct tax loss chains.

(2) Bulat 16V, Biscay Business, and Euro Councel et Development, France appeared in the money movements connected with Libra Graphics single deal (6) in contra-trading scheme 3 involving Morganrise.

(3) Zorba SRO, Slovakia (7), Scorpion Electronics, Portugal (4), Sino Time Finance Ltd, Hong Kong (4), Global Financial Services Management, British Virgin Islands (Address in Hong Kong) (8), Avoset, Estonia (3), and Regent, Poland (3) formed the cell of traders in contra-trading scheme 2 to which nine of the Appellants' disputed deals were connected.

(4) RCCI High Tec, Cyprus, SNV Nationwide, Cyprus, Sia Vundura, Lativia, and Liban Trust Communications, Lebanon were all involved in the three Appellant's transactions connected with contra- trading scheme 1.

112. The analysis of the Datastore information demonstrated connections between the traders in each of the cells identified above. Bulat 16V and Biscay Business, key participants in the direct tax loss chains and contra-trading scheme 3 shared the same director, a Mr Atanas Goranov, a Bulgarian National living in Spain. In contra-trading scheme 1 SNV Worldwide (a Cypriot registered company) and Sia Vundera (a Latvian registered company) both had a British director and beneficial owner. Global Financial Services Management and Sino Time Finance Limited, participants in contra-trading scheme 2 shared the same address in Hong Kong at Suite 811, Tsimshatsui Centre, East Wing, 66 Mody Road, Hong Kong. Both companies also had British directors and beneficial owners.

113. Of the remaining four companies in scheme 2[15], Zorba and Regent shared the same beneficial owner, Sebastian Davalos, a native Swede but living in Marbella, Spain. All four, Zorba SRO, Scorpion Electronics, Avoset and Regent, however, were linked together through their connection with Joakim Broburg. Mr Broburg provided references for Mr Davalos and Mr Neuvonen, the beneficial owner of Avoset, to open FCIB accounts. The company, Scorpion Electronics, had the same address as Coberg Trading, which was one of Mr Joakim Broburg's companies.

114. Joakim Broburg was recorded in the Spanish Companies Register as the director of Total Telecom Espana SL from 20 September 1999 to at least 17 April 2002, when the company was transferred to Dome International in Gibraltar. According to Officer Stone, all the transactions involving Total Telecom were vitiated by MTIC fraud, resulting in tax losses exceeding £17 million. On 5 September 2003 Officer Stone assessed Total Telecom for unpaid VAT in the sum of £1,027,941. The period

[14] The figures in brackets represented the number of times the trader appeared in the money movements associated with the direct tax loss chains or the specific contra scheme.

[15] Officer Stone provided the evidence on these four companies which was derived from his examination of the FCIB material.

covered by the assessment was 23 February 2002 to 5 July 2002. Officer Stone stated that it was within his knowledge that during 2005 and 2006 Joakim Broburg continued to feature in subsequent MTIC frauds and that he administered a number of conduit companies in other EU Member States.

115. Mr Souter asserted that Frederik Broburg, the brother of Joakim Broburg, was the director of Total Networks at the time of its involvement in MTIC fraud. Officer Stone was unaware of the separate existence of Frederik until Mr Souter's fourth witness statement dated 20 June 2011, when Mr Souter produced copies of the respective identification cards for Frederik and Joakim. Up to that point Officer Stone believed that Joakim and Frederik were one and the same person. Despite the separate existence of Joakim and Frederik, Officer Stone still maintained that Joakim was the brother in charge of Total Telecom in 2002 and the principal protagonist in the fraud[16]. Mr Souter disagreed, stating that Joakim Broburg informed him that he sold his interest in Total Telecom to his brother, Frederik in 1999. The Tribunal prefers Officer Stone's evidence regarding Joakim Broburg's involvement with Total Telecom which was substantiated by records of the Companies' Register in Spain. In contrast Mr Souter's assertions were based on uncorroborated conversations with Joakim Broburg.

116. Zorba SRO, Scorpion Electronics, Avoset and Regent were four of the Tier 2 EU customers and suppliers in contra-trading scheme 2. Officer Humphries identified. two other Tier 2 traders, Valdemara Electronics and Estocom Distribution which were not involved in the money flows associated with the Appellants' transactions. The director and beneficial owner of Valdemara and Estocom was a Mr Alex Leroy who held the position of Vice President of Sales with Total Telecom and was, therefore, also, connected with Joakim Broburg. Finally the trader, FAF International which featured prominently in the deals conducted by Libra Graphics in scheme 2 was linked to Joakim Broburg through a Mr Tommi Neuvonen.

117. The final aspect of Officer Henderson's analysis which was not challenged by the Appellants was the use of third party payments in the direct tax loss chains which had the effect of ensuring that the defaulting traders did not have the monies to pay for the consignments of mobile phones supplied to them.

118. Turning now to circularity of funds Officer Henderson identified circularity in 25 of the 29 deals entered into by the Appellants[17], taking into account companies which were linked. For example Bulat 16V and Biscay Business which had the same beneficial owner, and Sino Time and Global Financial Services Management which were both British owned companies based at the same address in Hong Kong.

119. The Appellants criticised the analysis, arguing that Officer Henderson just followed the money and ignored contrary indications in respect of invoice amounts and transaction dates.

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[16] See Transcript 29 October 2012, day 3 page 45.

[17] See paragraph 6.19 of HMRC's Revised Opening dated 8.10.2012

120. The Appellants' assertion that Officer Henderson just followed the monies was simplistic. In re-examination Officer Henderson was asked to explain his methodology. He stated that he would start with the Appellants' customer to trace the money to the UK acquirer, and back from the customer. Officer Henderson placed reliance upon the narrative of the transactions provided by the Paris Server rather than the timings of the transactions. This meant that he would prefer the transaction identified by the narrative rather than the one which was closer in time. Where there was no narrative Officer Henderson identified the best match on the information he had before him. Officer Henderson also stated that there were three extracts of the Paris Server. He had found that payments made late on a night were recorded in another extract as being made on the following day.

121. The Tribunal considers that Officer Henderson was correct to place reliance on the narrative, and that his analysis can be followed through primary documentation. The Appellants in their cross-examination put no tracing error to Officer Henderson. On balance the Tribunal is satisfied that there was a circularity of monies in 25 of the 29 disputed transactions.

122. The Tribunal's conclusion on circularity is supported by Officer Humphries' findings on circularity of goods in contra trading schemes 2 and 3 which were ascertained from the examination of the records held by the freight forwarder. Officer Henderson found circularity of monies in all the Appellants' deals connected to contra trading schemes 2 and 3,

123. The Tribunal is satisfied that HMRC analysis of the data retrieved from the FCIB servers demonstrated the fraudulent and orchestrated nature of the transactions to which the Appellants' deals were connected. The findings on the involvement of 21 traders outside the UK in these transactions, their organisation into cells and their connections with each other, the use of third party payments, and the circularity of monies supported the existence of an overall scheme to defraud public revenue.

***IP Addresses***

124. In respect of each payment made between FCIB accounts after 1 May 2006, the data uplifted showed which authorised signatories' account (denoted by an account number) was used for each payment (denoted by its EB number), and which IP address the payment instruction was made from. HMRC exhibited its analysis of IP addresses used at Schedule L to its closing submissions.

125. Most accounts have only one authorised signatory account, for example. Libra Tech and Graphics each have a single authorised signatory on their account (for Libra Tech, Christian Souter with a reference of 22806685; and for Libra Graphics, Christian Souter with a reference of 64631711). From that evidence HMRC accepted it was not possible to identify the physical person using the account in the name of the authorised signatory because the account name and password could be provided to another person.

126. Officer Henderson identified the use of same IP addresses by different traders in 12 of the 13 money chains analysed. For example in deal 25 the same IP address 207.195.242.16 was used on 6 June 2006 by Biscay Business for a payment at 18:27:06, by Bulat 16V for a payment at 18:36:05, by Derastec for a payment at 18:54:07, by Eurotronics at 19:15:14 and by Libra Tech at 19:18:04.

127. HMRC accepted that the evidence did not show that all IP addresses were identical and was, therefore, not consistent with a single mastermind sitting at a single computer controlling all the various payments. In HMRC's view this was unsurprising because a scheme of this nature was likely to have required more than a single individual. Further HMRC did not attempt to explain why certain IP addresses were common and not others (for example, Grange Computers, the Appellants' supplier never had a common IP address with any other traders). HMRC, however, relied on the consistencies in the use of IP addresses as further evidence of coordination and contrivance. In this respect HMRC relied on the evidence of Officer Letherby who explained that the use by traders of the same IP addresses indicated a greater level of contrivance than would be expected from an otherwise unrelated business[18].

128. HMRC pointed out that further support for coordination was found in the use of the same *portoloco* email addresses in account opening forms by two customers of the Appellants: Nova 2000 and Spabel Marketing.

129. The Appellants argued that the evidence on IP addresses was inconclusive about whether there was some sort of collusion between several parties. The Appellants pointed out that Officer Letherby had identified six possible explanations for the recording of the same IP addresses on the FCIB banking system. Mr Souter identified two more possibilities, namely that, the FCIB information was corrupted due to it being a copy of a copy. Next, the IP addresses were those of FCIB's own servers which account holders log on before connecting to the transactions server. In respect of the latter, the Appellants pointed out that Officer Letherby had accepted there were other servers in several locations (London, Paris, Kuala Lumper) linked to the FCIB system, which allowed them to connect to Dutch and Paris servers. According to the Appellants it was a possibility that the IP addresses recorded were those of FCIB's own remote servers through which the traders have accessed their accounts, or that the same Internet Service Provider had been used.

130. The Appellants also identified that the IP address for Eurotronics, the Appellants' customer, had switched between two addresses for which Officer Henderson could offer no explanation. Further the evidence showed that in those deals which were characterised by the use of common IP addresses, there were also other IP addresses logged into by different traders, which went against the proposition of a single controlling mind.

131. The Tribunal starts with the possible explanations for the use of common IP addresses by different traders. Mr Souter's two additional explanations were not put to Officer Letherby. The Tribunal notes that the Appellants made no challenge to the

[18] See Transcript Day 2 26 October 2012 at page 108

integrity of the data capture from the FCIB servers, which undermined Mr Souter's potential explanation of data corruption. In respect of Mr Souter's second explanation it appeared to be a variant of Officer Letherby's potential explanations d) and e).

132. On explanation d) which concerned the use of common proxy servers, Officer Letherby said in re-examination:

> "It would require some degree of coincidence or some considerable collaboration between the parties for them to use the same server for the same transaction chain at the same time, effectively or within close proximity to each other. It stretches the realms of possibility of random choice"[19].

133. On explanation e) which concerned the use of a common mobile data connection from a common provider:

> "…it is unlikely that someone overseas would choose to use, particularly for a business transaction where financial cost of initiating the transaction actually is a direct concern, that they would use an exponentially expensive service in favour of local internet provision or mobile phone internet provision".

134. The Tribunal considers that the common thread throughout Officer Letherby's explanations was that the pre-requisite for a shared use of IP addresses was that there must have been some degree of co-operation, discussion or commonality between the various parties so using. It follows that such co-operation was inconsistent with a portrayal of a market of individual traders competing with each other to secure the best deal. Thus the use of common IP addresses was strong evidence that the traders concerned were not trading at arms length.

135. The Tribunal is entitled to look at the evidence on IP addresses in context of the other evidence on the overall fraudulent scheme. The findings on the connections between the parties as disclosed in the contra-trading schemes and the FCIB Datastore replicated those found in the analysis of IP addresses. Thus Bulat 1.6V and Biscay used the same IP addresses, whilst the tier 2 EU customers and suppliers of contra-trading scheme 2 were shown to be sharing IP addresses (Zorba &Avoset; Regent & Avoset).

136. Schedule L showed that the Appellants used the same IP address as its principal customer, Eurotronics, and with a number of other companies involved in the deals (Kwality Trading, Bulat 16V, Avoset, and Headcom) of which the Appellants asserted they had no knowledge.

137. The Tribunal finds that the Appellants' attempts to undermine the specifics of Officer Henderson's evidence on common IP addresses were unsuccessful. The Appellants did not explain the significance of their observation that Officer Henderson was unable to offer an explanation for Eurotronics switching its IP addresses. The Appellants' submission about the non-existence of a controlling mind

[19] Transcript Day 2 26.10.12 Page 105 & 106

did not weaken HMRC's case on the significance of the shared used of IP addresses. HMRC relied on shared IP addresses to demonstrate an uncommon degree of co-operation between supposedly independent traders as opposed to proving the presence of a single controlling mind behind the fraud.

138. The Tribunal decides that the use of common IP addresses by a disparate set of traders purportedly trading at arms length was powerful evidence of contrivance, particularly when examined in the context of the other evidence on overall scheme of the Appellants' deals.

***The Appellants' Customers***

139. The Appellants' customers in the disputed deals were known to their domestic authorities for involvement in fraud, except CEMSA. HMRC provided no evidence of the Spanish authorities' view of CEMSA's trading activities. Instead HMRC relied on Officer Humphries' evidence of CEMSA's involvement in contra-trading.

140. Eurotronics although registered in Denmark, the Danish authorities have identified no known bank accounts or sales of goods in that country. Having been registered on 31 January 2006, the trader was deregistered by the trustee on 12 February 2007.

141. Nova 2000 was registered in Spain for VAT on 13 January 2005 and has been deregistered as a missing trader on 25 September 2006.

142. Elandour Development was registered in France. The trader failed to comply with an audit to cover the period 25 October 2005 to 31 August 2006. The director was a Dutch national with no obvious links to France. The French authorities considered Elandour to be a missing trader.

143. Fremont Europe Associates was registered in Spain for VAT on 20 December 2004. This trader was deregistered on 10 October 2006 on the basis that it did not have business premises at the declared domicile. A partner in Fremont, Jean Michel Francois Hochart, was also a director of the UK company, Iibizco Components Limited, which has been deregistered as a missing trader.

144. Spabel Marketing was registered in Spain. This trader was deregistered on 27 April 2006 on the basis that the company was not located at its declared domicile.

145. CEMSA was registered in Spain. Officer Humphries identified the role of CEMSA in contra-trading scheme 1. According to Officer Humphries the cost to CEMSA (in Spain) and Evolution (in France) of buying goods from UK traders in this period, rather than purchasing them from the originating French trader, was £8.3million which made no commercial sense.

146. The Tribunal finds that all but one of the Appellants' customers was deregistered for VAT by their respective domestic tax authorities in the period of April to June 2006 when the disputed deals took place. The Tribunal agrees with

HMRC that the deregistration and its timing were further proof of a fraudulent scheme to defraud public revenue.

***Deals 25-27 (Teknic Limited)***

147. The Appellants argued there was no tax loss in deals 25 - 27.

148. Deals 25 and 26 concerned Libra Tech and took place on 30 and 31 May 2006. Deals 25 and 26 involved the separate purchase and sale of 5,000 Nokia 8800 mobile phones, whilst deal 27 involved a consignment of three different models of mobile phones (2000 Nokia N91, 2250 Nokia 9300i and 2259 Nokia N80. The supply chains leading to Libra Tech in these three deals comprised the same traders: Profiteksas (Lithuania) – The Taxable Person Purporting to be Teknic Ltd – Infotel Communications – Fonedealers –Caz Distribution – Headcom – Grange Computers – Libra Tech.

149. Officer Arnold traced the connections between the various parties identified in paragraph 148 above and Libra Tech's exports from documentation seized from the freight forwarder (Pallet Network UK) which was used by Libra Tech in deals 25-27. Mrs Arnold had requested a visit of the freight forwarders because Infotel had been deregistered from VAT in April 2006. The documents seized included:

(1) Release notes dated 30 May 2006 from Profiteksas which recorded for deals 25 & 26[20] a consignment of 10,000 Nokia 8800 mobile phones with the supplier being Multimode Marketing SLC, and Teknic as the customer. In respect of deal 27[21] there were separate release notes, one for 2250 Nokia 9300i mobile phones, another for 2259 Nokia N80 mobile phones, and the final one for 2000 Nokia N91 mobile phones. Each of the release notes specified Multimode Marketing as the supplier and Teknic as the customer.

(2) Release notes dated 30 May 2006 from Teknic Ltd which recorded for deals 25 & 26 a consignment of 10,000 Nokia 8800 mobile phones with the supplier being Profiteksas , and Infotek Communications Ltd as the customer. In respect of deal 27 there were separate release notes, one for 2250 Nokia 9300i mobile phones, another for 2259 Nokia N80 mobile phones, and the final one for 2000 Nokia N91 mobile phones. Each of the release notes specified Profiteksas as the supplier and Infotek Communications Ltd as the customer. The Appellants did not take issue at the hearing with the misspelling of Infotel as Infotek in the Teknic's release notes.

(3) Release notes dated 30 May 2006 from Infotel Communications Limited which recorded for deals 25 & 26 a consignment of 10,000 Nokia 8800 mobile phones allocated to Fonedealers Ltd. In respect of deal 27 there were separate release notes, one for 2250 Nokia 9300i mobile phones, another for 2259 Nokia

[20] In deals 25 & 26 Libra Tech sold two separate consignments of 5,000 Nokia 8800 phones to Eurotronics.

[21] In deal 27 Libra Tech sold 2000 Nokia 9300i, 2259 Nokia N80 and 2000 Nokia N91 mobile phones in one consignment to Nova 2000.

N80 mobile phones, and the final one for 2000 Nokia N91 mobile phones. Each of the release notes allocated the mobile phones to Fonedealers Limited.

150. The money flows for deals 25 and 26 comprised the same parties and started with Biscay Business SL in Spain passing through various traders to Eurotronics which then paid Libra Tech. After which, the money flow followed the invoice supply chain as far as Fonedealers which then paid a Spanish company, Multimode Marketing SL (the supplier named in the Profiteksas' release notes). The flows were completed with a payment of Multimode to Biscay. The money flow for deal 27 followed a similar pattern to those of the previous two deals except that Fonedealers paid a Portuguese company, Acquired Solutions, which in turn completed the flow with a payment to Biscay Business SL. The Tribunal finds that the key features of the money flows were that they were circular, and that there was no record of a payment being made to Infotel, Teknic and Profiteksas.

151. HMRC concluded that Teknic's VAT registration number had been hijacked because:

(1) The trading in mobile telephones was inconsistent with the trading patterns of Teknic.

(2) The documentation relating to the importation of mobile telephones was inconsistent with genuine Teknic documentation, with contact details particularly not being for Teknic.

(3) The director of Teknic was cooperative with HMRC Officers and willing to allow them to look at his trading records and compare them with his claims to have undertaken only minimal sales of clothing in the relevant period.

(4) A subsequent visit to the premises of Teknic on 22 August 2006 by Officer Grunwell did not uncover any evidence that acquisitions or sales of mobile telephones had been conducted by Teknic.

152. On 30 November 2007 Officer Arnold issued an assessment in the sum of £959,670.11 against "The Taxable Person Purporting to be Teknic Limited", with a registration number of 963 8666 65. The assessment related to the VAT lost on deals 25 -27. HMRC maintained that such a hijack would be conducted only for fraudulent purposes. A hijacked trader was not registered for VAT and therefore did not complete or submit a VAT return. Thus the tax loss in deals 25 -27 was, therefore, fraudulent.

153. The Appellants primary submission was that the release notes were not sufficient evidence to support acquisitions by Teknic because:

(1) There were no sales invoices by Profiteksas to Teknic, or by Teknic to its alleged customer, Infotel.

(2) There was no other commercial documentation to support the supply by Profiteksas to Teknic (for example, purchase orders, CMRs, stock offers, contracts).

(3) Officer Arnold did not know herself who had acquired the goods.

(4) Officer Arnold stated that blockers operated to disguise the true acquirer of the goods.

(5) Officer Arnold did not believe that Teknic's alleged customer, Infotel, had supplied the goods because it either had been de-registered for VAT or its VAT number had been hijacked.

(6) There was no evidence of payment either to Teknic from its alleged customer or payment by Teknic to Profiteksas. Further there was no evidence of third party payments by Infotel.

154. The Appellants asserted that as Teknic did not receive any consideration, there was no supply for VAT purposes, which rendered Officer Arnold's assessment against TTPPB Teknic flawed. The Appellants contended that HMRC was required to set out its allegations of fraud clearly and with particulars. In deals 25-27 HMRC had pleaded that TTPPB Teknic was the defaulter causing the fraudulent loss of VAT which on the evidence was not substantiated. Thus HMRC has failed to establish that the Appellants' transactions in deals 25-27 were connected with a fraudulent tax loss.

155. In the alternative, the Appellants argued that if the release notes were evidence of the true position, the goods were in the UK when the supply was made, and, therefore, subject to UK VAT. In that case Teknic did not acquire the mobile phones as an intra-community supply which also rendered Officer Arnold's assessment against TTPPB Teknic flawed.

156. HMRC submitted that, on the balance of probabilities, the chains described for deals 25-27 in Annex A to Core Bundle B were correct. Accordingly, TTPPB Teknic Limited had been correctly identified as the defaulting trader in these deals. Further even on the alternative factual analysis advanced by the Appellants a tax loss would still have been fraudulently incurred in each deal chain.

157. HMRC pointed out that the Appellants did not challenge the evidence in relation to TTPPB Teknic which was set out in the witness statement of Officer Orr. According to HMRC it was notable that the deal documentation obtained by Officer Orr demonstrated the acquisition by the hijacked Teknic of telephones from Premisten (rather than Profiteksas, as in the Appellants' deal chains) which indicated that the involvement of the hijacked Teknic in the phone deals such as those connected to the Appellants' transactions was not an isolated event.

158. HMRC relied on the uplifted release notes to demonstrate that TTPPB Teknic acquired the goods from an EU trader. HMRC submitted that it was a reasonable inference to draw from the freight forwarder documents that TTPPB Teknic purchased the goods in question and sold them on to Infotel. While the Appellants relied on the FCIB evidence as showing no payments to TTPPB Teknic, this was unsurprising given that the defaulting trader in all direct tax loss deal chains traced by Officer Henderson received no payment.

159. HMRC contended that even if the Tribunal was not satisfied that TTPPB Teknic had acquired the goods HMRC was entitled to rely on two alternative scenarios to prove the tax loss. The first was that TTPPB Teknic had failed to account for tax

through its operation as a buffer trader. The second was that the evidence showed that the goods were subject to intra UK supply by Infotel which was a hijacked trader and did not account for tax. A fraudulent tax loss was therefore established through the actions of the hijackers of Infotel.

160. HMRC contended that the decision of Christopher Clarke J in *Red 12 Trading Limited v HMRC* [2009] EWHC 2563 (Ch) was authority for its view that alternative scenarios based on the evidence were available to it, if it failed to establish that TTPPB Teknic was the original importer. Further the Appellants' insistence that HMRC was bound by its pleading that TTPPB Teknic was responsible for the tax loss was contrary to the overriding objective of dealing with cases fairly and justly, in particular avoiding unnecessary formality and seeking flexibility in the proceedings. Finally the Appellants would suffer no prejudice, if the Tribunal found a fraudulent tax loss to have been incurred on the basis of one of the alternatives advanced. HMRC was clear in its opening submissions that a tax loss would equally be incurred were Profiteksas to have acquired the goods in the UK. HMRC contended that on any scenario, there was a fraudulent tax loss which was connected to the Appellants' transactions in deals 25-27.

161. The Appellants argued that HMRC had misunderstood the law. Teknic made no taxable supplies and therefore had no obligation to account for VAT. Further HMRC was not entitled to rely on the overall objective to get round its obligation to prove what it asserted. Finally unlike other transactions involving other alleged defaulters, there were no third party payment instructions or sales invoices issued by Teknic.

162. The Tribunal at this stage in the deliberation is examining whether HMRC has established a connection between the Appellants' transactions in deals 25 -27 with the fraudulent evasion of VAT. The Appellants by objecting to the designation of TTPPB as the defaulting trader was raising issues about the nature of fraud and its proof in alleged MTIC transactions.

163. Mr Justice Burton in *R (on the Application of Just Fabulous (UK) Ltd v Revenue & Customs Commissioners* [2008] STC 213 at paragraph 7 explained the nature of fraud in alleged MTIC deals:

> "The fraud is plainly committed, if the participants in such chains are dishonest, at the stage of the missing trader, although the loss may not crystallise until the Revenue has to pay out in full in respect of the return filed by the exporter".

164. The Advocate General in *Kittel* at paragraph 35 said that in every case in MTICs the bottom line was that an amount received in respect of VAT was not declared. Thus Mr Justice Lewison in *HMRC v Livewire Telecom Limited* [2009] EWHC 15 at paragraph 91 stated that "*Unless there is a missing trader somewhere further down the chain (or in a parallel chain) there is no fraud*". A missing trader may use a hijacked VAT number or it may register itself for VAT and simply disappear before the tax authorities take action (see Advocate General in *Optigen* [2006] STC 419 at paragraph 8).

165. The Tribunal has to be satisfied on the balance of probabilities that deals 25-27 involved a defaulting trader which failed to account for VAT. HMRC asserted this was met because the evidence showed that a trader hijacked the VAT number of Teknic Ltd and failed to account for VAT on its transactions with Infotel. The Appellant deployed four arguments challenging the existence of a tax loss in deals 25-27.

166. The first argument, namely Teknic made no taxable supplies, was based on the FCIB evidence showing that Teknic gave no consideration for the purported supplies of mobile phones. The Tribunal was not persuaded by this argument. The Tribunal in this Appeal is concerned with the Appellants' right to deduct and whether there has been a fraud in the deal chain to which the Appellants' transactions were connected. HMRC's evidence of the use of a hijacked VAT registration number and a failure to account for VAT was sufficient on the face of it to establish fraud in the deal chains for 25-27.

167. The fact that TTPPB Teknic did not actually give consideration was not conclusive of the proper characterization of its supplies for VAT purposes. The Tribunal is satisfied on the evidence that the reason for making no consideration related directly to the fraud perpetrated on the VAT system. The analysis of the money flows showed that in every deal no monies were paid to or by the defaulting trader, which meant that any action taken by HMRC to recover the outstanding tax would be frustrated by the trader's lack of resources.

168. The common system of VAT requires each transaction to be considered individually, per se and on objective criteria, without regard to its purpose or results. On objective criteria TTPPB Teknic was a taxable person engaged in the economic activity of selling and buying mobile phones. A fraudulent intention not to pay the consideration for its supplies was not relevant to the objective analysis of TTPPB Teknic's trades for VAT purposes. In this respect the VAT position of TTPPB Teknic's trades was no different from that of the Appellants if their transactions were showed to be vitiated by fraud. Thus in that case the Appellants' trades would still retain its character of taxable supplies. The Appellants, however, would be denied their right to deduct VAT. Likewise, Teknic's trades remained taxable supplies but HMRC would be entitled to take action to recover the VAT fraudulently evaded[22]. The Tribunal is, therefore, satisfied that Officer Arnold's assessment on TTPPB Teknic was validly made.

169. The Appellants' second argument concerned the strength of the evidence adduced by HMRC to prove that TTPPB Teknic was the defaulting trader. The Tribunal finds that HMRC adduced documentation in the form of release notes which showed that Teknic limited had purchased mobile phones from Profiteksas and sold

[22] Support for this view is found in paragraph 43 of *Mobilx:* "A person who has no intention of undertaking an economic activity but pretends to do so in order to make off with the tax he has received on making a supply, either by disappearing or hijacking a taxable person's VAT identity, does not meet the objective criteria which form the basis of those concepts which limit the scope of VAT and the right to deduct (see *Halifax para. 59 & Kittel par 53).*

them to Infotel. The provenance of the release notices being from the freight forwarder responsible for the movement of goods in deals 25-27 reinforced the involvement of Teknic in the deals, and their connection with the Appellants' transactions. The Appellants supplied no contrary evidence to challenge the tracing exercise conducted by Officer Arnold. The Appellants engaged Credit Risk Management to carry out extended verification of the deals but was unable to obtain any documentation relating to deals 25-27. The fact that there was no record of payment by Teknic for its purchases was unsurprising for the reasons given in paragraphs 167 and 168 above. Likewise the absence of invoices and other commercial documentation did not in themselves undermine the inference of Teknic's involvement from the release notes, particularly when having regard to the wider circumstances which showed that in all probability the hijacking of Teknic's VAT registration number.

170. Mr Justice Christopher Clarke's judgment in *Red 12* gives support to a wider examination of individual transactions which includes their attendant circumstances and context. Officer Orr's evidence was relevant in demonstrating that Teknic's VAT registration number had been hijacked and that the involvement of the hijacked Teknic in phone deals was not an isolated event. The wider evidence on deals 25-27 in respect of the composition and length of the transaction chains, the shared membership (Headcom and Grange Computers) with other direct tax loss chains, and the circular money flows demonstrated their fraudulent nature, and the existence of a defaulting trader.

171. The Tribunal is satisfied on balance that HMRC has correctly identified TTPPB Teknic Ltd as the defaulting trader in the Appellants' deals 25-27.

172. The Appellants argued that if the release notes were evidence of the true position, Teknic did not acquire the mobile phones as an intra-community supply which rendered Officer Arnold's assessment against TTPPB Teknic flawed. Mr Justice Christopher Clarke in *Red Trading 12* at paragraphs 83 and 84 gave the argument that the defaulter had to be the original importer short shrift:

> 83. The fact that descriptions of the classic or simplest form of MTIC fraud habitually refer to the defaulter as the importer (or vice versa) does not mean that a right to deduct input tax on the ground of MTIC fraud can only be denied if HMRC establishes that the defaulter was the original importer. No domestic or EU authority establishes that that is so, and such a requirement would, in my judgment, be contrary to principle. …….
>
> 84. In many cases of MTIC fraud the defaulter, i.e. the company which fails to account for VAT and beyond which HMRC will not have been able to trace the chain, will be the actual importer. But it need not be so. ……. What is needed for an MTIC fraud to work is an importation without payment of VAT, a trader who disappears without accounting to HMRC for the output tax it has received, and an export which generates an entitlement to claim back input tax….. In order to justify denial of the right to deduct input tax there must be knowing participation in a transaction connected with fraudulent evasion of the

> tax. If that is established, the right is lost. It would be inconsistent with that principle, and an unmerited boon to fraudsters, to require the authorities to prove that the defaulter was the original importer".

173. The Tribunal's principal finding is that TTBBP Teknic was the defaulting trader which acquired the mobile phones from Profiteksas (a Lithuanian company). If, however, the Appellant's legal analysis on intra-community supplies is correct, the Tribunal maintains that its finding of TTBBP Teknic as the defaulting trader was unaffected by incurring a tax loss as a buffer trader in deals 25-27.

174. The Appellants' final argument concerned the possibility of HMRC relying on Infotel as the defaulting trader if HMRC failed to convince the Tribunal on its principal proposition on Teknic. In view of the Tribunal's findings on TTPPB Teknic, the arguments on Infotel were academic. Having said that, the Tribunal is satisfied on the evidence of Officer Arnold that Infotel was a hijacked trader which failed to account for tax on its supplies to Fone Dealers in deals 25-27.

175. The Tribunal considers that HMRC would have been entitled to rely on Infotel as the defaulting trader if its principal proposition had been unsuccessful. The Appellants' objection to the possibility of an alternative finding stemmed from its reliance upon the established principle that HMRC must prove the fraud or dishonesty particularised in the pleadings. In the Tribunal's view, the identification of a different defaulter from the one pleaded did not offend the established principle because the nature of the fraud remained the same as that pleaded, namely the connection of the disputed transactions to a defaulting trader.

176. The Tribunal concludes that there was a tax loss in each of the deals 25, 26 and 27, which was occasioned by the fraudulent activities of the TTPPB Teknic. Libra Technology's transactions were connected to these fraudulent tax losses.

***Opportunities Recruitment International Limited (ORIL) Deal 29***

177. The Appellants argued that the alleged contra-trader ORIL in deal 29 did not act as a typical contra-trader which usually disguised its transactions to avoid interventions from HMRC. The Appellants pointed out that ORIL submitted a repayment claim for over £5 million in period 03/06 with HMRC interviewing its director on 31 March 2006. According to the Appellants, HMRC was demonstrating significant interest in ORIL's activities at the time of the Appellants' disputed transactions.

178. HMRC maintained that ORIL's role in the disputed transactions was manifestly fraudulent. The fact that ORIL was subject to investigation by HMRC in respect of its earlier claim for period 03/06 did not prove that ORIL's role in acquiring goods in period 06/06 for onward sale to UK traders (in order to artificially balance its repayment claim for this period) was other than fraudulent.

179. The Tribunal makes the following findings of fact in respect of ORIL:

(1) ORIL was incorporated on 23 October 2001 and registered for VAT with effect from 19 January 2004. ORIL declared its principal business as the sale of bespoke birthday and greetings cards. No greetings cards were ever sold. On 15 March 2004, ORIL notified HMRC it intended to commence trading mobile telephones.

(2) The period 06/06 was the first period in which ORIL had declared any EC acquisitions. No acquisitions from the EC had been declared in the periods 03/04 to 05/06.

(3) In period 06/06 ORIL entered into six broker deals which involved the despatch of consignments of cameras purchased from RCCI Hi-Tech (in Cyprus) to EU traders. Each of the six deals have been traced directly to a tax loss incurred by a hijacked trader known as Taxable Person Purporting to be Grange Solutions/ Wade Tech Limited.

(4) After the six broker deals ORIL undertook six acquisition deals which concerned the purchase of mobile telephones from Kom Team Sarl (in France). These mobile phones were sold onto EU traders through a series of UK broker traders which included Libra Graphics and Nex Trading.

(5) In 06/06 the respective values of ORIL's outputs and inputs were £8,853,125 and £8,832,071 which meant that its claim for input tax on the broker deals was effectively matched by the output tax claim on the acquisition deals resulting in a small repayment of £579.52.

(6) Across all broker chains ORIL achieved a consistent £2.00 per unit mark-up whatever the price of the product. All of its deals in period 06/06 were conducted on a back-to-back basis with many happening on the same day. ORIL has supplied no evidence of insurance for its acquisition deals. Further no evidence of written contracts has been provided. HMRC also identified discrepancies in the CMRs supplied by ORIL Finally the due diligence undertaken by ORIL on its suppliers and customers in the 06/06 deals was virtually non-existent.

(7) ORIL was a member of the contra trading scheme 1 involving the contra-traders A – Z Mobile Accessories, Jag Tec, Red House International Limited and Starmill International Limited. Under scheme 1 the mobile phones originated with Kom Team, a French trader, which had been the subject of investigations by French authorities. Kom Team sold the goods to the five contra-traders. After which the goods went to a group of nine buffer traders and then onto a group of 32 UK broker traders.

(8) Deal 29 of the Appellants' disputed transactions has been traced back from Libra Graphics to ORIL through two buffer traders, Stardex and Tradex Corporation. Deal 29 involved a circular flow of money from and to Kom Team Sarl.

180. The Tribunal is satisfied on the above facts that ORIL was operating as a dishonest contra-trader in period 06/06. All its broker transactions have been traced back to a tax loss. ORIL's entered into the acquisition deals just after the broker transactions. ORIL attempted to disguise the tax losses in its broker transactions by

matching its input tax claim against the output tax claim on the acquisition ones. ORIL's high turnover in 06/06 and the manner in which it conducted its business supported the conclusion that it was engaged in fraudulent trading. The fact that HMRC was investigating ORIL at the material time did not displace the overwhelming evidence of ORIL's dishonesty.

181. Deal 29 which involved the sale and purchase of 3,500 Nokia 9300i mobile phones by Libra Graphics was traced back to ORIL.

**Summary of Findings on an Orchestrated Scheme to Defraud**

182. The fraudulent nature of the direct chains was demonstrated by the following findings (paragraph 89)[23]:

(1) The chains for deals 1,5, 8-13, 19, 20, 22-27 were all traced to a direct tax loss.

(2) Each loss was occasioned by the fraudulent activities of a missing or hijacked trader.

(3) The contrived nature of each chain in respect of length and composition.

(4) The use of consistent mark ups in small rounded numbers by the buffer traders, and the flouting of business terms in deals 1, and 8 to 13.

(5) The structure of long deal chains served to disguise the overall nature of the fraud by putting distance between the missing trader and the broker trader.

183. The Appellants' deals 2, 3, 4, 6, 7, 14-18, 21 and 28-29 were traced to six contra traders (Kwality Trading International, Morganrise, Epinx (also known as Libra Fair Trades), Jag Tec, A-Z Mobile Accessories and ORIL) organised in three distinct schemes. The Tribunal's findings in relation to the contra-traders were as follows (paragraph 102)[24]:

(1) Overall each scheme showed a distinct pattern with the mobile phones passing from a distinct small group of EU suppliers to a distinct small group of EU customers. In scheme 2 the two groups were almost identical. The destinations in each scheme were maintained even after the mobile phones have passed through a larger number of different UK traders.

(2) There was no commercial reason for the mobile phones to be imported into the UK. The EU customers consistently paid unnecessarily high prices to UK suppliers for mobile phones which were available more cheaply in mainland Europe.

(3) Circularity of goods was a prevalent feature throughout the three schemes.

(4) The schemes were associated with substantial tax losses which were disguised by the dishonest activities of the contra-traders which offset the input

[23] See paragraph 176 for the specific findings on TTPPB Teknic

[24] See paragraph 180 for the specific findings on ORIL

tax claims in their broker transactions with the output tax liability in their acquisition transactions.

184. HMRC's analysis of the data retrieved from the FCIB servers demonstrated the fraudulent and orchestrated nature of the transactions to which the Appellants' deals were connected. The findings on the involvement of 21 traders outside the UK in these transactions, their organisation into cells and their connections with each other, the use of third party payments, and the circularity of monies supported the existence of an overall scheme to defraud public revenue (paragraph 123).

185. The use of common IP addresses by a disparate set of traders purportedly trading at arms length was powerful evidence of contrivance, particularly when examined in the context of the other evidence on overall scheme of the Appellants' deals (paragraph 138).

186. All but one of the Appellants' customers was deregistered for VAT by their respective domestic tax authorities in the period of April to June 2006 when the disputed deals took place. The Tribunal agrees with HMRC that the deregistration and its timing were further proof of a fraudulent scheme to defraud public revenue (paragraph 146).

187. The Tribunal, therefore, makes the following findings for each of the disputed transactions on the first three issues, VAT loss, occasioned by fraud, and connection of the Appellants' transactions with such a fraudulent VAT loss:

(1) Each of the Appellants' deals 1,5, 8-13, 19, 20, 22-27 was connected to a fraudulent tax loss. The losses were occasioned by TTPPB Lewis Davis Productions, Lewis Davis Productions, MediaWatch 360, TTPPB AAA Multilink, and TTPPB Teknic Ltd

(2) Each of the Appellant's deals 2, 3, 4, 6, 7, 14-18, 21 and 28-29 was connected to a fraudulent tax loss via the dishonest actions of six contra-traders (Kwality Trading International, Morganrise, Epinx (also known as Libra Fair Trades), Jag Tec, A-Z Mobile Accessories and ORIL).

188. The Tribunal is also satisfied that the Appellants' transaction chains 1 – 29 were the product of orchestration by fraudsters as part of an overall scheme to defraud the public revenue. All the transaction chains led to fraudulent tax losses, which were disguised by either the length of the chains or the actions of dishonest contra- traders. The orchestration of the scheme was manifest from the regular appearance of specific traders in the invoice chains and money flows, the connections between them, and their organisation into distinct cells. The circularity of both monies and goods and the use of common IP addresses confirmed the fraudulent nature of the transaction chains.

189. The existence of an overall scheme to defraud implied that the success of the scheme depended upon each participant buying from and selling to persons designated by those orchestrating the scheme. HMRC argued that as the Appellants were involved in such a scheme and played the key role of broker they were knowing parties to the fraud.

190. The Appellants, on the other hand, asserted they were innocent parties and victims of the alleged fraudulent practices of others. The Appellants contended that it would be wholly inequitable to bear all the losses. The Appellants rejected HMRC's assertion that they knew or should have known their transactions were tainted by fraud. The Appellants were adamant that the processes adopted at the time they entered into the disputed transactions were reasonable and proportionate. The Appellants pointed out that there was no evidence that the Appellants dealt directly with the contra-traders and the defaulting traders occasioning the tax losses.

191. HMRC suggested that the existence of an orchestrated overall scheme to defraud posed two questions in the alternative:

(1) Why the Appellants were involved unless they were knowing parties to the scheme? or

(2) In the alternative, were the Appellants innocent dupes?

192. The Tribunal now deals with the outstanding issue of whether the Appellants knew or should have known at the time of entering the disputed transactions that they were connected with the fraudulent evasion of VAT.

## The Appellants' Knowledge

193. HMRC argued that there was no plausible explanation for Mr Souter being manipulated without his knowledge or acquiescence. HMRC relied on the high degree of co-ordination and connections between the Appellants and their immediate traders and of other traders which featured in the overall fraudulent scheme to demonstrate the implausibility of the Appellants being innocent dupes.

### *Grange Computers, Notebook Express, Nex Trading and T3K*

194. The Tribunal starts with Grange Computers which was the Appellants' sole supplier in the periods at issue in this appeal. The director of Grange Computers was Anthony Rose. Mr Souter had known Mr Rose and his family for many years. They worked together brokering transactions on behalf of the Appellant, Libra Technology. Mr Souter originally stated that Mr Rose was an employee of Libra Technology which was later changed to a consultant because Mr Rose was not subject to PAYE/NIC regulations. Mr Rose set up Grange Computers in 2005 after having a break of about six months from Libra Technology

195. In the same VAT periods as in this Appeal Grange Computers was also the supplier of mobile phones to Notebook Express and Nex Trading. In the first contra trading scheme[25] Libra Graphics, Nex Trading, Notebook Express and Grange Computers all acted as broker traders, exporting goods to EU customers. In May 2006 Notebook Express brokered five deals which had identical transaction chains to those in deals 25, 26 and 27 involving Libra Technology. On 30 and 31 May 2006 Notebook Express and Libra Technology (deal 27) respectively sold the same models

[25] See paragraph 83 above

of phones to the same customer (Nova 2000). The differences between them were the actual number of units, the price and that the goods were invoiced one day apart. Mr Souter accepted that he knew that Grange Computers supplied Nex Trading and Notebook Express at the same time it supplied the Appellants. Mr Souter denied that he had any knowledge of the supply chains involving Notebook Express and Nex Trading.

196. Mr Souter's commercial rationale for dealing exclusively with Grange Computers was that he wanted to purchase stock from a company he trusted and one which would perform tough diligence on its suppliers. According to Mr Souter, Mr Rose fitted the bill. Mr Rose knew the business inside out and would do the right thing in finding those types of suppliers with which to do business. Further Mr Souter had worked with Mr Rose for two years and trusted him.

197. The sole shareholder of Notebook Express was Libra Holdings, a company beneficially owned by Mr Souter. The director of Notebook Express was Russell Williams. When Mr Souter was first asked by Officer Arnold on 20 February 2007 if he had any knowledge of Notebook Express. Mr Souter replied that he knew of the company, had never traded with it but had bought personal items from Notebook Express. Mr Souter later acknowledged he was an employee of Notebook Express in the UK, and owned the beneficial interest in it. Mr Souter also set up a branch of Notebook Express in Spain of which he was sole director. Mr Souter denied that he was involved in buying and selling mobile phones for Notebook Express. According to Mr Souter he had little involvement with the day to day activities of Notebook Express. His role was to source products from the Far East which would be retailed under the brand name of Nex.

198. Russell Williams, the director of Notebook Express, was also director of Nex Trading. Mr Souter denied that he had any interest in Nex Trading stating that Mr Williams set it up as his own company. Mr Souter, however, accepted that Mr Williams approached him in 2005/2006 about whether it was appropriate for Nex Trading to source mobile phones from Grange Computers. Also Mr Souter was unable to give a plausible explanation for why a document signed by him had an email address of *Christian@NexTrading.com.*

199. Mr Rose, the director of Grange Computers, was also the director of Platinum Base Enterprises Limited. Officer Arnold when examining the 2004/05 audited accounts for Libra Technology noticed an entry of £35,410 in the cost of sales which was described as a profit share. Officer Arnold requested an explanation from Mr Souter on several occasions but never received a response. On 7 June 2007 the Appellants' accountant wrote to Officer Arnold stating that the profit had been shared with Platinum Base Enterprise Limited. Officer Arnold's requests for further information on 6 September 2007 and 12 March 2008 on Platinum Base Enterprises went unanswered. Eventually Officer Arnold undertook a Dun & Bradstreet enquiry on Platinum Base Enterprises which revealed the directorship of Mr Rose.

200. Mr Souter later explained that he understood Platinum Base Enterprises to be an investment vehicle owned entirely by Mr Rose in which he raised funds from family

and friends. Platinum Base Enterprises injected £300,000 into Libra Technology which was mainly used to pay for VAT exports. Mr Souter believed that the funds were injected around 2001/2002. He, however, did not give a convincing answer for why the profit share entry appeared in the 2005 accounts if the investment was in 2001/02. Mr Souter suggested it was an accounting error and that it should have been on the balance sheet and carried forward.

201. Mr Rose along with Steve Moran and Marc Kimsey were directors of T3K which was a company set up to conduct due diligence on behalf of its customers. Three of whom were the Appellants and Grange Computers. T3K assisted the Appellants with drafting the templates of its commercial documents with the result that they shared the same format as those for Grange Computers.

202. The Tribunal is satisfied that Marc Kimsey of T3K and Grange Computers[26] took a role in assisting Libra Technology to apply for an FCIB account, in that his email address appeared on Libra Technology's FCIB account opening form of 9 February 2005. Mr Souter offered various explanations for the presence of Mr Kimsey's e mail address ranging from bafflement to Mr Kimsey setting up the computer systems for Libra Technology. The Tribunal agrees with HMRC that Mr Souter's answers failed to explain why the accounts opening form did not show Mr Souter's own email address.

203. The use of Marc Kimsey's email address suggested that the Appellants were not solely in control of their FCIB accounts. Further proof of this fact was found in Officer Arnold's visit report of 26 July 2006 where she contemporaneously recorded that Mr Souter was unable to operate his own FCIB account when asked. She also recorded Mr Souter saying that his accountant would need to be present to open the account. Mr Souter denied that he had said this. He stated that it was a misunderstanding on the part of Officer Arnold whom he believed was asking for copy bank statements. FCIB, unlike many online banking facilities, did not offer online statements to the account holder. Officer Arnold thought the purported misunderstanding was nonsense. She had already seen copies of the bank statements on 25 July 2006, and had already asked for more detailed accounts which she was told could not be obtained after three months had elapsed.

204. The Appellants' accountant produced a signed and dated board resolution for Libra Graphics authorizing Mr Souter to open and operate its bank account. Mr Souter, however, was unable to provide the corresponding mandate for him to operate the Libra Technology's bank account. Mr Souter considered that such formalities were unnecessary for relatively small undertakings, such as Libra Technology.

***Eurotronics (Polina Petrova)***

205. Polina Petrova was the director of the trader Eurotronics APS which was the Appellants' customer in 12 of the disputed deals. Ms Petrova was the partner of Mr Souter and the mother of his daughter.

[26] Marc Kimsey's name appeared on Grange Computers' documentation

206. Eurotronics registered for VAT in Denmark and began trading in January 2006 purchasing nearly £90 million worth of goods from UK traders in the space of five months. Mr Souter stated that Eurotronics was based in Denmark because of the price differential between the UK and the Scandinavian markets. Also the competition was not as fierce as in the UK because of the relatively small number of traders operating the secondary market in Denmark. HMRC, however, pointed out there was no evidence that Eurotronics sold any phones to Danish companies. The information obtained from the Danish Authorities showed that Eurotronics' customers were from outside the UK but not from Denmark. In which case Ms Petrova would have made much larger profits if she had set up business in the UK and operated as a broker.

207. Eurotronics customers included companies controlled by the Broburg circle, OUAvoset (Valdemara/Leroy), Estocom (J.Neuvonen,/Leroy), Scorpion (J. Broburg[27]). Other customers were Nova 2000 which was also a customer of the Appellants, and Bulat 16V and Euro Councel et Development which appeared regularly in the money flows in the Appellants' direct tax loss chains, and in contra-scheme 2.

208. During periods 04/06, 05/06 and 06/06 Notebook Express also supplied mobile phones to Eurotronics. The Appellants in some deals sold to Eurotronics at a lower prince than other customers. On 26 May 2006 Libra Technology sold 1,500 Nokia N80's for £358 per unit, whilst the same make and model of phones were sold to CEMSA at £374 per unit. Also on 26 May 2006, Nokia 9500s were sold to Eurotronics by Libra Technology for £241 per unit, while the same make and model of phones were sold to CEMSA at £249 per unit.

209. Mr Souter did not disclose to Officer Arnold that Ms Petrova was his partner when she was investigating the Appellants' due diligence. Mr Souter said that he would have told Officer Arnold if she had asked. Officer Arnold pointed out that this was not a question she would automatically have asked. Mr Souter did not see the significance of Ms Petrova being his partner. His response in cross examination was "*Why should I, What has that got to do with anything"*.

210. Mr Souter first met Ms. Petrova in late 2004/early 2005. She had been living in the UK for six to seven years and was working at a restaurant as a manageress. Mr Souter was unable to give any explanation as to why his partner, Ms Petrova with whom he was living as a couple at the time was commuting to and from Denmark to run a company which did not trade in Denmark. He was defensive in evidence as to the day to day details of his relationship. Also there was evidence that the faxes from Eurotronics bearing the May 2005 stamp originated from the Appellants' fax machine. Mr Souter when asked to explain why the Appellants' and Eurotronics' shared the same fax number: *"I don't know, maybe we had the same fax machine. I don't know"* before revising his answer *"I meant the same make and model fax machine"*. Mr Souter also assisted Ms. Petrova in setting up Eurotronics'

[27] J Broburg through Scorpion having a common address with Coberg, of which J Broburg was director at the material time.

documentation. Eurotronics' letter of introduction was in near identical terms to that for Grange Computers.

211. Mr Souter's explanation for trading with Eurotronics was that he wished to help Ms Petrova create her own business. Also he did not want to see the products that he had just sold re-entering the UK as could happen by selling to other purchasers. Mr Souter decided commercially it would make sense to sell to someone that he trusted abroad and who would not re-export the product back into the UK.

212. Mr Souter stated that the Appellants were unable to sell to Eurotronics' customers because he did not have Ms Petrova's contacts which arose through Eurotronics' independent marketing. Mr Souter's explanation, if true, suggested that Ms. Petrova, who was new to the trade, not only found the Broburg circle by coincidence but also had better contacts and knowledge than Mr Souter. His explanation, however, was contradicted by the fact that the Appellants were trading in 2006 with companies from the Broburg circle, namely, Coburg (J Broburg) and Proinserco (Leroy). Also Mr Souter later in his cross-examination said that he probably mentioned to Ms Petrova the companies he dealt with to in order to help her to find leads for selling and buying stock. Mr Souter acknowledged that he had been in the business for a long time and that a lot of people knew his companies.

213. Mr Souter in cross examination stated that the probable explanation for selling the same products to Eurotronics at a lower price than that to CEMSA was that Eurotronics had a lower target price as a result of pressures from its customers. Mr Souter argued that doing deals with Eurotronics at a reduced price made good business sense because the Appellants were still achieving a mark up, albeit lower than that secured with the CEMSA sales.

214. Mr Souter in his witness statement asserted after examining the deal chains for the sales to CEMSA and Eurotronics that the stock had been acquired by Grange Computers from different suppliers at different prices. According to Mr Souter, although the transactions were completed on the same day, the price may have been agreed verbally between those further up the chain prior to completion. Officer Arnold considered Mr Souter's reasoning was inconsistent with other parts of his witness statement about prices fluctuating daily which meant that transactions were usually completed within a day, and that the prices offered by suppliers were reviewed to ensure they were in line with prevailing market conditions.

***The Appellants' Loan Agreements and Funding***

215. In July 2006 Mr Souter informed Officer Arnold that the input VAT on the Appellants' transactions was funded by personal finance. He made no mention of any loans or private investors, and the existence of any associated companies, apart from the Appellants.

216. Officer Arnold was, however, unable to reconcile the Appellants' bank statements to the tune of £7.5 million which prompted requests for information dated 12 September 2006 and 13 October 2006 from Mr Souter on the discrepancies in the

statements. On 18 October 2006 the Appellants' solicitor stated that the discrepancies were made up of loans to the Appellants to cover the shortfall whilst the VAT returns were being verified. Officer Arnold requested copies of the loan agreements. On 9 November 2006 the Appellants' solicitor stated that she had clarified the matter with Mr Souter and that the monies should have been described as an injection of capital by the holding company rather than as loans. The Appellants eventually advised Officer Arnold of the name of the holding company (Libra Holdings) and in addition provided copies of the loan agreements transacted with Quebec Inc of Canada and the Libantrust Communication.

217. The Tribunal makes the following findings of fact on the loan agreements:

(1) There were five separate loan agreements between the Appellants and Quebec Inc and Libantrust Communication involving a total sum of £2,738,000 borrowed by the Appellants in the period May to July 2006.

(2) The loan agreements did not refer to the other outstanding loans. Also there was no indication of the order in which the separate loans would be repaid.

(3) No security was given for the loans from Quebec, which was considered unusual by Mrs Hamilton, an HMRC accountant, having regard to the size of the loans and the risk to the lenders. The Libantrust agreements mentioned that the loans were secured against trading activities, which, according to Mrs Hamilton was vague and unenforceable.

(4) There were no penalties if the loans were not repaid.

(5) The repayment terms in the Libantrust agreements were not clear. The terms obliged the Appellants to repay only as much as possible.

(6) The loans did not appear to have been drawn up professionally with only one agreement having a wet signature coupled with errors in the registered address of Libra Graphics and the spelling of Montreal.

(7) Mr Souter in cross examination was unable to explain plausibly how the loans came about, stating that he was contacted out of the blue.

(8) Mr Souter had never met the lenders.

(9) The Appellants had not repaid the loans. Quebec and Libantrust had not taken any action to recover the sums lent under the agreements.

(10) Mr Souter gave unsatisfactory and contradictory answers about why the Appellants took out the loans. Mr Souter stated at first that he was cash starved and very short of cash, which conflicted with the evidence of an injection of £337.000 from Libra Holdings on 15 July 2006. Mr Souter then acknowledged that he had personal finance at the time of the transactions but he had other uses for it and did not want to tie up his finances in the Appellants' business. In Mr Souter's view, he preferred to borrow money from companies, such as Quebec and Libantrust even though he had to pay exorbitant interest..

218. The FCIB analysis revealed that the payments from Quebec to the Appellants were preceded by payments from the trader Ixcel into the FCIB account of Quebec

Inc. The Ixcel payment had been traced back to the traders Biscay/Bulat16V., EU traders with a common director, which had a significant presence in the money chains for the Appellants' direct tax loss deals and also in the contra-trading scheme 3[28]. Thus there was a direct connection between the monies given by Quebec to fund the VAT on the Appellants' disputed transactions and the financiers of the direct tax loss chains and contra trading scheme 3.

219. When faced with the connection of Quebec and Biscay/Bulat Mr Souter accepted that the Appellants' lender was involved with the setting up of the fraudulent scheme. Mr Souter, however, denied that he had any knowledge of such a relationship, suggesting that he had been conned and manipulated in a clever way.

220. Mr Souter was reluctant to supply details of the injection of funds from his holding company, Libra Holdings, which was registered in the British Virgin Islands. On 20 February 2007 the Appellants informed Officer Arnold that the only information that could be supplied under confidentiality rules was the name and address of the director. The Appellants' bank accounts revealed that Libra Holdings had transferred funds to the Appellants of £110,900 in 2005 and £337,000 on July 2006. Mr Souter was not prepared to disclose which companies had invested their funds with Libra Holdings.

221. Finally on the issue of the Appellants' funding, the Tribunal has already found that Libra Technology was the subject of a profit sharing arrangement with the company Platinum Base Enterprises Limited of which Mr Rose was a director.

***Appellants' Knowledge of the Prevalence of MTIC Fraud***

222. Mr Souter accepted that the Appellants were aware of the incidence of VAT fraud in the mobile phone sector. Mr Souter in his cross examination stated that he knew his companies were swimming with sharks in the mobile phone sector, and that he had to be extremely careful with the transacting of deals.

223. Officer Mendes had responsibility for Libra Technology prior to the involvement of Officer Arnold in 2006. Officer Mendes had frequent contact with the directors of Libra Technology in 2003 and 2004. Nine visits had been recorded from July 2003. HMRC had supplied the Appellants on several occasions with copies of Notice 726 dealing with joint and several liability of traders.

224. HMRC had denied previous repayment claims by Libra Technology which involved sales to an European Trader on 30 May 2002 and 26 June 2002. The denied deals had been traced to Total Telecom, a company under the control of Joakim Broburg.

225. Libra Technology and Total Telecom were parties in the High Court proceedings of *Teleos PLC & Others, R (on the application of) v Customs and Excise* [2004] EWHC 1035 and the European Court of Justice case of *Teleos and Others*

[28] See paragraph 111 above

[2007] C-409/04. The European Court rejected HMRC's argument that it was entitled to deny input tax simply because the goods had not been removed (non-economic activity). The outcome of the decision was that HMRC assessed Total Telecom for the full amount of VAT due, £17.5 million and repaid VAT to other participants including Libra Technology involved in the proceedings.

226. Mr Souter pointed out that HMRC accepted at the time of the *Teleos* case that Libra Technology did not know that its transactions with Total Telecom were fraudulent, which was why HMRC repaid the input tax to Libra Technology. Having read the *Teleos* decisions Mr Souter conceded the existence of a fraud in the Total Telecom deals. He was not sure whether the fraud had perpetrated by Total Telecom or someone behind it. Mr Souter said he was furious with Frederik Broburg[29] for involving Libra Technology in these deals and never spoke to him afterwards.

***The Broburg Connection***

227. The Tribunal finds the following facts on the connection between Mr Souter and the Appellants with Joakim and Fredrik Broburg and the Broburg companies:

(1) The parents of Joakim and Frederik Broburg were senior political figures in Spain. Their father was a large property developer in Costa del Sol and held many other business interests there.

(2) Mr Souter met Joakim and Frederik Broburg when he was at University at Malaga in Spain. He used to go to Marbella and play tennis with Joakim and Frederik Broburg. Mr Souter was half Swedish and had something in common with Joakim and Frederik Broburg through their Swedish Nationalities.

(3) Mr Souter had continued to remain in contact with Joakim Broburg. Mr Souter accepted that he had spoken to Joakim Broburg about these appeals, and that Joakim Broburg provided the information contained in his fourth witness statement dated 20 June 2011. Mr Souter has had no recent contact with Frederik Broburg. Mr Souter believed that Frederik Broburg lived in the USA.

(4) Ms. Petrova had met Joakim Broburg when Mr Souter was playing tennis.

(5) Mr Souter and Joakim Broburg were company secretary and director respectively of Jill Miro UK which according to Mr Souter was involved in the wholesaling of reading glasses in the UK. The company ceased trading in 1998.

(6) In 1997 and 1999 Mr Souter and Frederik Broburg formed three companies, Europallet (UK) Ltd (marketing of pallets), Planet Telecom (UK) and Nepture Telecom Ltd (both companies involved in the wholesaling of mobile phones).

(7) Joakim Broburg was the director of Total Telecom Espana SL from 20 September 1999 to at least 17 April 2002, when the company was transferred to Dome International in Gibraltar. Total Telecom was involved in MTIC fraud

[29] Mr Souter maintained that Frederik not Joakim Broburg was in control of Total Telecom. The Tribunal disagrees see paragraph 115.

with tax losses exceeding £17 million. The Tribunal preferred Officer Stone's evidence that Joakim Broburg not Frederik Broburg was the person behind Total Telecom (see paragraphs 114 and 115 above).

(8) Joakim Broburg controlled the following companies: Powertec Computer LDA, Mundinri Ltd, Bulgarian Electronics Ltd, Planet Telecom, Global Gateways Iberia SL, Global Communications Ltd, Coburg Ltd.

(9) Joakim Broburg was associated with Alexis Leroy, a French National residing in Spain. The Tribunal prefers the evidence of Mr Stone who has established links between these two individuals, namely, Alex Leroy's position as Vice President Sales of Total Telecom, and the common business address of Calle Las Medranas 31, 29670 Me San Pedro de Alcantra, Malaga, Spain 29670[30]. Alex Leroy was director of Proinserco, Estocom Distribution, Valdemara Electronics, Peoria, and UAB Uzupio Distribution. Mr Souter accepted that he had visited the business premises at Calle Las Medranas

(10) Joakim Broburg was associated with Tommi Neuvonen, a Finnish National but with a contact number in Spain. Mr Tommi Neuvonen was director of FAF International. Joakim Broburg provided a reference to FCIB on behalf of FAF International which stated that he had been in a business relationship for the better part of ten years. Mr Tommi Neuvonen also worked for Coburg, one of Joakim Broburg's companies.

(11) Joakim Broburg was associated with Sebastion Davalos, a Swedish National with an address in Marbella Spain. Mr Davalos was the beneficial owner of various companies including Regent, Zorba, Con Animo and Nano Infinity. Joakim Broburg provided various references to FCIB for some of Mr Davalos' companies. Mr Broburg's reference for Con Animo stated that he knew Mr Davalos and that Con Animo was an honourable company.

(12) Joakim Broburg was associated with Jussi Neuvonen, a Finnish National, and the beneficial owner of Avoset. Joakim Broburg provided a reference to FCIB for Avoset stating that he knew Mr Jussi Neuvonen and that Avoset was an honourable company.

(13) Mr Souter sought to downplay Joakim Broburg's connections with Tommi and Jussi Neuvonen, and Sebastion Davalos by stating that Joakim Broburg was a FCIB sub agent for which he received commission for introducing persons to FCIB. The Tribunal considers that the content of the references, their shared Scandinavian origins, and the Spanish address/contact for Mr Davalos and Mr Tommi Neuvonen suggested that the relationships between Joakim Broburg and the three named persons were established ones.

(14) Mr Souter stated that Joakim Broburg had no connection with Scorpion Electronics LDA. The Tribunal is satisfied that there was a connection as demonstrated by the facts that Joakim Broburg provided Scorpion with a reference to FCIB, Scorpion had traded with Coberg, one of Mr Broburg's

[30] See paragraph 10 of Officer Stone's 3rd witness statement dated 22 July 2011

companies, and Scorpion had the same address as Powertec (another of Mr Broburg's companies).

(15) Zorba SRO (Mr Davalos), Scorpion Electronics, (Joakim Broburg) Avoset (Jussi Neuvonen) and Regent (Mr Davalos) formed the cell of traders as identified by the FCIB analysis in contra-trading scheme 2 to which nine of the Appellants' disputed deals were connected.

(16) Zorba SRO, Scorpion Electronics, Avoset, Regent, Valdemara Electronics (Alexis Leroy) and Estocom Distribution (Alexis Leroy) were the six Tier 2 EU customers and suppliers identified in contra-trading scheme 2.

(17) FAF International (Tommi Neuvonen) featured prominently in the deals conducted by Libra Graphics in contra-trading scheme 2.

(18) Eurotronics (Mr Petrova's company and the Appellants' customer) traded with Avoset (Alexis Leroy), Estocom (J.Neuvonen), and Scorpion (J. Broburg.

(19) Officer Stone stated that it was within his knowledge that during 2005 and 2006 Joakim Broburg continued to feature in subsequent MTIC frauds and that he administered a number of conduit companies in other EU Member States. Officer Stone also identified that companies controlled by Joakim Broburg and Alexis Leroy had featured in published decisions of the FTT Tribunal dealing with Appeals against the refusal of repayment claims because of their connection with MTIC fraud.[31]

(20) In February 2006 Libra Graphics sold Nokia N70 mobile phones to the value of almost £1 million to Proinserco (Alexis Leroy). In March 2006 Libra Graphics also sold Samsung mobile phones to the value of £400,000 and Nokia N70 mobile phones to the value of £1 million to Proinserco.

(21) On 1 March 2006 the Appellant, Libra Graphics attempted to validate with HMRC at Redhill the VAT registration numbers of Proinserco and Coberg Trading (Joakim Broburg). On 4 April 2006 and 10 April 2006 Libra Graphics attempted again to validate the registration numbers of Proinserco and Coburg Trading. HMRC refused to validate the registration numbers.

(22) After the trades with Total Telecom in 2002 the Appellants continued to do business with companies controlled by Alexis Leroy and Joakim Broburg into 2006.

***Due Diligence***

228. There was no evidence of due diligence undertaken by the Appellants on the their customers, Fremont Europe Associates SL and Spabel Marketing, and on Quebec and Libantrust, the companies which loaned monies to the Appellants. Mr Souter accepted that with hindsight the Appellants should have carried out due diligence on Quebec and Libantrust.

[31] See paragraph 15 of Office Stone's witness statement 3 dated 22 July 2011.

229. The due diligence on its customers Nova 2000, Elandour Development and CEMSA were cursory and generally after the event. The Appellants ignored the creditworthiness checks on these three companies, which indicated that the Appellants should have been wary of doing business with them.

230. The Appellants engaged the company T3K to conduct their due diligence procedures on Grange Computers and Eurotronics, which in the Tribunal's view, was a meaningless exercise given the conflict of interest posed by the directorships of Mr Rose in T3K and Grange Computers, and Mr Souter's declaration that he traded with Grange Computers because of his lengthy and close association with the individuals running them. Essentially Grange Computers was doing the due diligence on itself.

231. Despite the Tribunal's reservation about the meaningfulness of the due diligence carried out on Grange Computers and Eurotronics, the actual due diligence completed was not in accordance with the written procedures of T3K. Also the Appellants ignored the negative indicators identified.

232. In respect of Grange Computers, the letter of introduction was undated, the trade application form signed by Mr Rose was dated 19 July 2006 after the dates of the disputed trades and the trade reference for Grange Computers was given by Notebook Express which was beneficially owned by Mr Souter. The Experian credit check for Grange Computers put the company in the highest risk category.

233. Eurotronics' letter of introduction was undated and largely identical to the Grange Computers letter of introduction. The letter stated that *"our experience has been built up over a combined period of 15 years"*. Given that Ms Petrova would have been 27 in 2006, it was not clear to whom this reference to 15 years of experience related. The accountant's reference provided for Eurotronics was dated 9 June 2006, after trading had commenced. Reference was made in a letter from T3K to Eurotronics dated 18 May 2006 to a request for due diligence from Christian/ Anthony at Grange Computers, which suggested that Mr Souter was also involved in the affairs of Grange Computers. The trade reference for Eurotronics was provided by Bryan Spiller at Libra Graphics, dated both 24 January 2006 and 7 June 2006. This stated that Libra Graphics had traded with Eurotronics for 12 months. Given that Eurotronics commenced trading in January 2006, the Appellant, Libra Graphics has provided on the face of it a false trade reference to bolster its own due diligence checks into a customer.

234. Mr Souter was unable in cross examination to give a satisfactory explanation for the inconsistencies in the due diligence on Grange Computers and Eurotronics. He accepted that a T3K report on Grange Computers did not have much validity. Mr Souter also agreed that it seemed a bit ridiculous to pay for the due diligence report on Eurotronics, particularly as Libra Graphics had been a trade referee for Eurotronics.

235. Mr Souter insisted that the Appellants had instructed Veracis to conduct due diligence on their behalf. Mr Souter, however, produced no evidence of this except a 2005 Veracis report on Grange Computers, which indicated Mr Rose's intention to move steadily away from the higher risk activities. HMRC have interpreted Mr

Rose's intention as referring to trade in high value mobile telephones. It would appear that the Appellants paid little attention to the contents of the Veracis Report, as the disputed deals were conducted in April and June 2006.

236. The Appellants also relied on the fact that Libra Technology was visited by Officer Mendes on nine occasions to verify VAT returns and inspect the deal documentation. Officer Mendes, however, did not examine Libra Technology's due diligence informing Mr Souter that it was his responsibility to be satisfied about the integrity of the deal chains.

***Insurance***

237. There was no evidence that the goods were adequately insured. Mr Souter produced no insurance documents which referred expressly to the Appellants by name, or to the specific goods consigned by the Appellants. Further Mr Souter adduced no evidence of being invoiced for insurance.

238. Instead Mr Souter relied on a Standard Insurance Policy document of Willis Limited Marine Insurance entered into on 23 March 2006 for a term of 12 months and which provided cover for consignments of up to £1 million carried on one vehicle. The covering letter with the insurance policy document was not specifically addressed to the Appellants. Even if this insurance policy applied to the Appellants' transactions, their reliance on it was misplaced. HMRC carried out an analysis of the value of each deals, and the number of trailers used to carry the consignments which was incorporated in Schedule J to the core bundle. The analysis revealed that in all but six of the transactions, the Appellants were under insured for the consignments carried.

***IMEI Scanning***

239. The documents produced by the Appellants regarding IMEI scanning did not demonstrate that the scans actually took place, except a single Ontime Logistics invoice which referred to quantities and models corresponding with the phones in core deal 17

***Formal Contracts***

240. Mr Souter insisted that the Appellants had formal written contracts for its transactions, which comprised a customer contract note as read with the standard terms and conditions. The Appellants, however, did not produce details of the standard terms and conditions.

241. Mr Souter accepted in cross examination that the standard terms and conditions of the Appellants and Grange Computers applied simultaneously. This would have been the case in all the disputed deals. In each deal, the Appellants' supplier contract note to Grange Computers, provided that the Appellants' standard terms and conditions applied to the transaction. Conversely the customer contract note provided to the Appellants by Grange Computers stipulated that the deal was subject to its

standard terms and conditions. Mr Souter did not consider it unusual for one commercial deal between distinct trading entities to have two sets of terms and conditions.

***Commercial Documentation***

242. The Appellants' customer contract notes required the customer to return and sign a document entitled *Confirmation of Received Goods* within five days. HMRC's analysis of the *Confirmation* documents revealed that in 23 deals, the document was either missing or had a material defect or not returned within five days. Mr Souter was not concerned about the flaws in the *Confirmation* documentation arguing they were irrelevant and supplementary to CMRs and other evidence of export of goods.

***Legal Ownership***

243. Mr Souter accepted that title did not pass to the Appellants until they had paid for them. Further he acknowledged in cross-examination that did not know who owned the goods at any one time. In core deal 1, the goods were shipped by Libra Graphics on 13 April 2012, even though no payment was made to Grange Computers until 11 May 2006. Shipment was made by the Appellants before payment to its supplier also in deals 3, 4, 7, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19 20, 21, 22, 23, 24, 25, 26, 28.

***Manuals***

244. Mr Souter stated in cross examination that attention was paid to the type of manual included with the mobile phone. The Appellants' purchase orders and invoices, however, did not specify the type of manuals required. HMRC's analysis at Schedule K to the Core Bundle shown that virtually all the manuals provided with the mobile phones were in English, which was inconsistent with the first language of the countries to which the consignments were dispatched.

***Grey Market***

245. Mr Souter accepted in his witness statement that his understanding of the grey market, which he called the secondary market, largely coincided with that of Mr Fletcher. Mr Souter argued that the Appellants had to move quickly in this market where supply, demand and price fluctuated daily. He stated that the Appellants did not speculatively acquire stock but relied on established trading partnerships to meet the product requirements of its customers. Mr Souter explained that in such a market where there was price volatility and the margins were small the Appellants looked to complete the transactions quickly because they would not be the only supplier looking for specific stock.

246. Mr Souter's depiction of the Appellants engaging in bona fide trades trying to make a profit in a highly competitive market was undermined by his evidence in cross-examination:

(1) The Appellants did not try and improve its profit margins by approaching tier one distributors, such as the Sol Group, which was specifically mentioned by Mr Souter. Mr Souter assumed that Grange Computers was obtaining its stock from large wholesalers.

(2) Mr Souter was not concerned about the close relationships and arrangements between the Appellants, Grange Computers, T3K, Notebook Express, Nex Trading and Eurotronics, even though such arrangements ran counter to his perception of a highly competitive market where the participants did not disclose details of their suppliers and customers. The fact that T3K did due diligence for the Appellants meant that Mr Rose, and, thereby, Grange Computers, had access to the Appellants' customer lists.

(3) The admission of an unnamed individual on behalf of Libra Technology that the company carried out an export for a Spanish company. In evidence, Mr Souter was unable to explain the record of the admission in HMRC's visit report and give a commercial explanation for so acting for the Spanish company. Mr Souter also stated that a UK company might legitimately ask him to carry out an export if that company did not have the funds to do so.

(4) Mr Souter's explanation that CEMSA, a customer of the Appellants, would pay more than necessary by virtue of having a higher target price. This sort of behaviour was inconsistent with normal market behaviour, particularly as Mr Souter confirmed it was possible to check the current market price by phoning dealers advertising their wares on the International Phone Traders (IPT) website.

(5) Mr Souter offered no persuasive explanation for why Grange Computers passed up the possibility of making greater margins by exporting the mobile phones rather than selling them to the Appellants. Equally it made more commercial sense for the Appellants to sell direct to Eurotronics' customers, particularly as it would appear the majority of those customers were known to Mr Souter..

247. The evidence showed that the Appellants did not engage in the four grey market opportunities identified by Mr Fletcher. They were box breaking, arbitrage, volume shortages and dumping.

248. The Appellants were not involved in box breaking ("handset unlocking" or "SIM unlocking"). Such trading required access to large labour resources and facilities and was inconsistent with the scale of operation ran by the Appellants. They employed two members of staff who worked the telephones from an office.

249. The Appellants were not involved in arbitrage in which mobile telephones were bought in one country and exported to another for the purpose of taking advantage of differential handset pricing in those countries. In the Appellants' trading, goods were purchased in the EU by one trader, introduced into the UK briefly, and then exported to EU traders. In some instances the eventual EU customer was in the same country as the original EU supplier. This trading pattern was not consistent with an attempt to take advantage of any differentials in pricing policy. The Appellants also largely traded in Nokia mobile telephones. Nokia had an homogenous pricing policy across

Europe which meant that the only potential arbitrage opportunity would arise from fluctuations in currency values. Given that the Appellants' deals were conducted on a back-to-back basis there was no evidence that the Appellants sought to take advantage of currency fluctuations. Indeed, all transactions took place in Sterling.

250. The Appellants argued that Mr Fletcher undermined his own evidence about Nokia's homogenous rigid pricing policy, by accepting the existence of volume discounts and the availability of marketing support payments. The Tribunal disagrees with the Appellants' assertion. The Tribunal's understanding of Mr Fletcher's evidence was that the homogenous policy applied equally to volume discounts, namely, the same discount was applied across the EU. The Tribunal was not convinced of the relevance of marketing support payments to pricing, particularly as they were made from a separate budget, and had to be applied to advertising.

251. The Appellants adduced no evidence that their trade in mobile phones arose from spot failures or volume shortages in the market. They did not retain stock and were not engaged in the trade of specific types of mobile telephone. The Appellants used generic product descriptions on their invoices.

252. Finally there was no evidence that the Appellants were engaged in dumping opportunities The Appellants bought their stock from companies other than authorised distributors or manufacturers. Further Mr Souter admitted in evidence that the consignments of Nokia N70 N90s N91s and 9300 phones were all high end and would not have been dumped.

253. The Appellants submitted that Mr Fletcher's evidence carried little weight. They argued that he had minimal experience of the mobile phone wholesale market in the relevant period. In the Tribunal's view Mr Fletcher held the necessary credentials for giving his evidence. He was a chartered accountant with a Masters in Business Administration from the London Business School. He had over 15 years experience in the telecoms industry, holding positions in audit, accounting, corporate finance and international business development. More recently he had worked as a strategic adviser to participants and investors in the industry. He also had the assistance of two colleagues who had direct experience of the wholesale grey market in mobile phones.

254. The Appellants suggested that the research relied upon by Mr Fletcher did not include data involving business to business sales. The Appellants overlooked Mr Fletcher's response in cross examination when he stated that the possibility of grey market goods getting into business to business channels did not affect the conclusions in his report[32].

255. Finally the Appellants contended that M Fletcher's evidence that authorised distributors did not over purchase to gain advantage of volume discounts had been contradicted by the contents of the report prepared by KPMG for the *Anti Gray Market Alliance*. The Tribunal notes that this report did not deal with the grey market in mobile phones.

[32] See Transcript Day 4 30 October 2012 56:20

256. The Tribunal considers the Appellants' challenge to the weight to be attached to Mr Fletcher's contradictory. The Appellants acknowledged that Mr Fletcher's evidence supported many of their assertions about the existence of a buoyant grey market and its operation[33] which in the Tribunal's view enhanced the accuracy and the relevance of Mr Fletcher's report.

***The Findings on Knowledge***

257. The Tribunal finds as follows:

(1) Mr Souter has not conducted his dealings with Officer's Arnold in a straightforward manner. He failed to disclose until later the true status of Ms Petrova as his wife and mother of his child. He did not tell Officer Arnold about the involvement of Mr Rose's investment vehicle, Platinum Base Enterprises, in Libra Technology until confronted with the profit-share entry in the audited accounts. He deliberately downplayed his role in Notebook Express until he was found out by Officer Arnold's enquiries. He gave misleading information on the funding arrangements for the Appellants by denying the existence of loans. He has refused to give details of the companies investing in Libra Holdings which has provided finance for the Appellant's trading activities.

(2) Mr Souter was fully aware at the time of entering the disputed transactions of the high incidence of fraud in the mobile phone trade sector.

(3) The Appellants did not have an arms length relationship with its supplier, Grange Computers. At the heart of this relationship was the longstanding friendship between their two directors, Mr Souter and Mr Rose. The latter had also worked with Mr Souter as a director/consultant in setting up deals for Libra Technology from 2002 to 2004. Mr Rose also had invested monies in Libra Technology through Platinum Base Enterprise, and presumably benefited from the profit share agreement which appeared in the 2004/05 accounts for Libra Technology. Mr Rose's knowledge of the Appellants' business continued after he set up Grange Computers through his directorship of T3K which conducted the Appellants' due diligence. Mr Souter, on the other hand, was held out in the letter from T3K dated 18 May 2006 as having some involvement in the business affairs of Grange Computers.

(4) This blurring of the commercial boundaries between the Appellants and their supplier, Grange Computers, was emphasised by the sharing of commercial documentation templates and the help given by Marc Kimsey, of T3K and Grange Computers, with the setting up of Libra Technology's FCIB account. The Tribunal is also satisfied that Mr Souter could not on his own operate the Appellants' FCIB accounts, which suggested that Mr Kimsey had a more active role in the Appellants' banking arrangements.

(5) Mr Souter's justification for dealing exclusively with Grange Computers was not based on commercial considerations. The Appellants could have made considerably more profit if they had sourced from suppliers further down the

[33] See paragraph 46(f) of Appellants' closing submissions dated 9 November 2012

chain. Grange Computer's mark up on the deals was significantly more than other buffer traders. The evidence of the higher price charged to CEMSA indicated that the Appellants knew that Grange Computers was not securing the best market price for the telephones. Mr Souter's trust in Mr Rose for delivering clean chains proved to be misplaced considering that all the disputed deals were traced back to a fraudulent tax loss. Mr Souter knew that the best way to secure a clean chain was to cut out the intermediate traders and trade with tier one distributors such as Sol Trading but he made no effort to do this.

(6) Equally there was no commercial rationale for Grange Computers to sell its mobile phones to the Appellants. Grange Computers had knowledge of the Appellants' customers through the involvement of Mr Rose, Mr Kimsey and T3K in the Appellants' business affairs. Grange Computers gave up the opportunity to make more money by not exporting direct to the Appellants' customers.

(7) Ms Petrova's instant success in the wholesaling of mobile phones was incomprehensible on normal business grounds given her lack of experience in this trade sector, and her decision to set up operations in Denmark where she had no connections.

(8) Likewise Mr Souter's reasons for trading with Ms Petrova (Eurotronics) had no business logic. Mr Souter stated that he wanted to help Ms Petrova to set up a business, and to ensure that the goods did not return to the UK. By doing so Mr Souter gave up the chance to make more profit by not selling direct to Ms Petrova's customers. Further Mr Souter had no guarantee that the goods would not return to the UK because on his account he had no control over the actions of Eurotronics' customers.

(9) Mr Souter's rationale of helping Ms Petrova suggested a more plausible explanation for Ms Petrova's instant success with the wholesaling of mobile phones, namely, that in effect he was running Ms Petrova's business. This conclusion was supported by the evidence on the nature of their relationship, the improbability of Ms Petrova's commute to Denmark, the use of the same fax machine for transmitting the respective companies' business documentation, the provision of a false trade reference and the drafting of documentation exaggerating Ms Petrova's experience, Mr Souter's extensive knowledge of the wholesale mobile phone market and finally Mr Souter's connections with Eurotronics' customers.

(10) Eurotronics' Customers included companies from the Broburg circle of companies, the findings on which are set out in paragraph 227 above. The Tribunal is satisfied that Mr Souter found these customers for Eurotronics through his longstanding association with Joakim Broburg

(11) Mr Souter's links with Mr Williams and his interest in Mr Williams' companies, Notebook Express and Nex Trading, which had trading relationships with Grange Computers and Eurotronics supported the existence of a coherent and an orchestrated group of traders engaged in mobile phone trading. Mr Souter was the common denominator in this trading group (the Appellants, Grange Computers, Eurotronics, Notebook Express and Nex Trading).

(12) The Appellants' loans with Quebec Inc and Libantrust Communication had no features of commercial loans: vague repayment terms, no penalties, and no security given. The wider circumstances surrounding the loans added further doubt on their commercial authenticity. The offer of the loans to Mr Souter apparently came out of the blue. The Appellants have not repaid the loans. Quebec Inc and Libantrust have taken no steps to recover the monies due from the Appellants.

(13) The discovery that Bulat/Biscay financed the purported loans to the Appellants shed light on the true nature of the loans. Bulat/Biscay featured prominently in the money movements associated with the Appellants' direct tax loss deals and with contra-trading scheme 3. The involvement of Bulat/Biscay provided a plausible explanation for the commercial unreality of the money advances from Quebec Inc and Libantrust. They were not loans but monies given to the Appellants to facilitate the fraud on the revenue.

(14) The role of Bulat/Biscay in the purported loans and Eurotronics' trades with the Broburg companies that formed part of the Tier 2 EU customers and suppliers in contra-trading scheme 2 undermined Mr Souter's assertions that he was unaware of the overall fraudulent scheme to defraud public revenue.

(15) The Appellants carried out no effective due diligence on its supplier and customers. Mr Souter was forced to admit the absurdity of engaging T3K to report on Grange Computers. He also accepted that it was ridiculous to pay for due diligence on Eurotronics, particularly as Libra Graphics acted as Eurotronics' trade referee. There was no evidence that the Appellants had engaged Veracis to conduct due diligence on their behalf.

(16) The Appellants did not have insurance in place for their transactions. The Tribunal was not convinced that the Willis Limited Marine Insurance Policy applied to the Appellants' transactions.

(17) There was no evidence that the Appellants performed IMEI scans on the consignments purchased.

(18) Mr Souter's assertion that there was nothing unusual in having two sets of terms and conditions governing the Appellants' transactions with Grange Computers confirmed the commercial unreality of the trading relationship with Grange Computers.

(19) Mr Souter's indifference about the flaws with the *Confirmation of Received Goods* documentation, the shipment of goods before legal title had passed to the Appellant and the inclusion of incorrect manuals demonstrated his disregard of the Appellants' stated business practices.

(20) There was no evidence that the Appellants availed themselves of one of the four grey market opportunities identified by Mr Fletcher. The Appellants' practices ran contrary to Mr Souter's depiction of the grey market as fast moving and highly competitive. The Appellants made no attempt to improve its profit margins, and had no arms length relationships with their trading partners.

***Tribunal's Conclusion on Knowledge***

258. The Court of Appeal in *Mobilx* emphasised that the knowledge test was simple and should not be over-refined. The question before the Tribunal is, having regard to objective factors, did the Appellants knew or should have known at the time of entering the disputed transactions that they were connected with fraud. The question is essentially one of fact to be determined having regard to objective facts or factors. The Tribunal in approaching this question should have regard to the big picture, meaning all the circumstances surrounding the transactions in question.

259. The test in relation to the Appellants' state of knowledge remains the same whether the transaction chain involved contra-trading or a simple tax loss chain. Mr Justice Briggs in *Megtian Limited (in Administration) v The Commissioners for HMRC* [2010] EWHC 18 (Ch) said at paragraphs 37 and 38:

> "In my judgment there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding took place.
>
> Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be demonstrated precisely which aspects of a sophisticated multi-faceted fraud he would have discovered, had he made reasonable inquiries. In my judgment sophisticated frauds in the real world are not, invariably susceptible as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases including Livewire that might be an appropriate basis for analysis".

260. Mr Justice Roth in *Powa (Jersey) Ltd* agreed with Mr Justice Briggs concluding at paragraph 53:

> "In any event, it is clear from the Court of Appeal judgment in Mobilx, where one of the three cases under appeal was Blue Sphere Global, that no special approach is required in a case involved in contra-trading. The correct test as regards knowledge is always the same. It is the test derived from Kittel as set out in para [59] of Moses LJs judgment:…"

261. The Appellants contended that there was no direct evidence that they were knowing participants in MTIC fraud. The Appellants argued that the HMRC's case was based upon inference from a wide range of factors; no single set of facts was put forward as demonstrating that the Appellants must have known of the connection to fraud.

262. The Appellants submitted that the Tribunal should take care in analysing such a range of factors to avoid imputing the trader with knowledge of matters that were only appreciable with the benefit of hindsight. The Appellants referred to the FTT decision in *Hira v HMRC* [2011] UKFTT 450:

> "115. When considering "a wide range of factors" it is difficult to be forensically analytical about when a trader's "suspicion" of a connection with fraud actually hardened into "knowledge" of that connection; and only marginally less difficult to say when that hardening should have taken place.
>
> 116. A very convincing picture will need to be painted before a tribunal can make an inferential finding of actual knowledge of a connection to fraud".

263. The Appellants' maintained that there was insufficient evidence to prove that they knew or ought to have known that the only reason for their transactions were that they were connected to fraud.

264. The Tribunal does not find the citation from *Hira* helpful. The Tribunal has to be satisfied that the Appellants knew or should have been known of the connection to the fraud at the time they entered each transaction. HMRC has to prove on the balance of probabilities that the Appellants had the requisite state of knowledge at the relevant time

265. In this Appeal the Tribunal has found that each of the Appellants' disputed transactions was connected to a fraudulent tax loss and that the transactions were part of an overall scheme to defraud. It follows from this finding that the Appellants were involved in an overall scheme to defraud, and that they performed a critical role in the fraud by operating as a broker trader responsible for the claim of the VAT repayment. The question then is did the Appellants know or should have known of the fraud when they entered the transactions or were they innocent dupes manipulated by the fraudsters.

266. HMRC argued that the only plausible explanation for the Appellants' involvement in the scheme was that they were knowing parties to the fraud. Mr Souter insisted that the Appellants were manipulated by fraudsters.

267. The Tribunal's findings on the Appellants' knowledge portrayed a compelling picture that the Appellants knew at the time of entering the transactions that they were connected with fraud.

268. The Tribunal found a high degree of co-ordination and co-operation between the Appellants, its supplier, principal customer and associated companies which went significantly beyond what would be expected in commercial relationships and extended to the Appellants' bank account and details of their customers. Behind this web of corporate harmony sat a group of individuals bound together by their relationships with Mr Souter.

269. The Appellants' way of doing business with its partners dominated by a high degree of co-ordination and strong personal relationships replicated features found in

the overall fraudulent scheme of trading involving connected companies and the co-ordination of activities as represented in the overall scheme by the use of common IP addresses and the circularity of monies and goods.

270. The findings on the Appellant's funding arrangements in particular the "loans" and the involvement of Bulat/Biscay in those "loans" indicated that the Appellants' activities were being co-ordinated by persons close the fraud. The funding role of Bulat/Biscay and Ms Petrova's trades with Broburg companies undermined Mr Souter's assertion that he was unaware of the overall fraudulent scheme to defraud public revenue.

271. The Appellants' trades with Eurotronics and Grange Computers were bereft of a commercial rationale. The Appellants forwent the opportunity to maximise their profits by not cutting out Grange Computers from their supply line and by not selling direct to the customers of Eurotronics, which were on the Tribunal's findings introduced by Mr Souter. Equally Grange Computers missed their chance to sell direct to the Appellants' customers, of which it had full knowledge.

272. The Appellants' conduct of their business did not conform to the demands of a highly competitive and fast moving secondary market as described by Mr Souter. The Appellants made no attempt to get close to the first tier distributors. They bought and sold goods above market price. Their relationships with their trading partners were not arms length. There was no evidence of the Appellants exploiting a grey market opportunity.

273. The fact that the Appellants carried on trading despite meaningless due diligence, the absence of insurance and title to the goods, and the disregard of commercial practices purportedly agreed between the parties demonstrated the contrived nature of their transactions. The Appellants knew whatever happened they would get paid.

274. The Appellants argued that Mr Souter was of good character with a long history of working in the mobile phone sector. The Tribunal found that Mr Souter's credibility as a witness was undermined by the manner in which he dealt with Officer Arnold's enquiries. Overall Mr Souter's evidence was unconvincing when confronted with the strength of HMRC's case against the Appellants. Apart from Mr Souter, no witnesses were called on behalf of the Appellants.

275. The Appellants relied on the frequent visits made by Officer Mendes to verify their VAT returns. The Tribunal placed no weight on Officer Mendes' evidence. The visits happened before the dates of the disputed transactions, and at a time when HMRC's knowledge of the complexities of MTIC fraud was in its infancy. Officer Mendes' evidence, in any event, did not assist the Appellants' case. Essentially Officer Mendes said it was the Appellants' choice with whom they traded, and their responsibility to ensure the soundness of their due diligence. The Tribunal has dealt with the other points raised by the Appellants in the body of decision.

276. The Tribunal is satisfied from its findings at paragraph 257 and discussed above that the Appellants knew at the time of entering the disputed transactions that each of those transactions was connected with the fraudulent evasion of VAT.

**Discrimination Argument**

277. The Appellants' argued that HMRC's policy of selecting one class of traders namely exporters on the basis of resources available was discriminatory and contrary to the EU law principle of non-discrimination.

278. The Appellants' further argued that in Libra Graphic's case there was specific discrimination by allowing Mediawatch over £1 million input tax credit on transactions on the basis that it relied on invoices allegedly issued by the defaulting trader, a Taxable Person Purporting to be Lewis Davis Productions. The Appellants pointed out that Mediawatch was the defaulting trader in deals 8-13, 19, 20, 22 and 23. Also according to the Appellants. Officer Stone had no explanation for why Mediawatch had received the tax repayment of over £1 million.

279. The Tribunal considers that the discrimination point has been comprehensively rejected by the Upper Tribunal on two occasions in *S & I v HMRC* [2012] UKUT 87 (TCC) and *Powa (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC). Mr Justice Newey stated in *S& I* at paragraphs 33-37

> " [33] Another ground of appeal relies on the principle of nondiscrimination. One implication of the principle, Mr Patchett Joyce argued, is that EU law needs to be applied uniformly. That was not the case, it is said, in the present context: HMRC denied input tax to S&I and exporters (referred to as "brokers") but not to "buffers" in the chains who bought and sold phones within the United Kingdom.
>
> [34] It was similarly submitted to the FTT that HMRC should be barred from contesting input tax entitlement if their approach was tainted by a discriminatory policy for which there was no objective justification. The FTT, however, decided that HMRC's conduct was not relevant. Among other things, it concluded that "the effect of the Kittel principle is to limit a trader's right to repayment of VAT" rather than to confer a discretion on HMRC (paragraph 82), with the result that "HMRC's action cannot affect the proper amount of tax in this case" and "the actions of the administration in applying that law and in selecting the cases in which they seek to apply it are irrelevant to us" (paragraph 84). If, the FTT went on, "S&I say that HMRC's actions are, in this case, or more generally, contrary to EU law, then that cannot be a matter for this tribunal for we have no general jurisdiction to review their actions: S&I must seek relief in a different forum" (paragraph 84).
>
> [35] A nondiscrimination argument was also rejected in *4 Distribution Ltd v Commissioners for Her Majesty's Revenue and Customs* [2009] UKFTT 242 (TC). In that case, the FTT (Judge Walters QC and Ms O'Neill) took the view that "circumstances which demonstrate that the Appellant has abused its right to repayment of input tax also

demonstrate that it has abused any right not to be discriminated against as a trader supplying to an entity in another Member State" (paragraph 133). The FTT continued as follows:

> "134. The ECJ said in Kittel at [54] that 'Community law cannot be relied on for abusive or fraudulent ends' and cited Kefalas and Others (Case C367/96) [1998] ECR I2843 at [20], Diamantis (Case C373/97) [2000] ECR I1705 at [33] and Fini H (Case C32/03) [2005] ECR I1599 at [32] in support of that proposition.
>
> 135. In any event, we are not satisfied that the circumstances of this appeal do, or even could, give rise to any right in the Appellant's favour not to be discriminated against as a trader supplying to an entity in another Member State.
>
> 136. It seems to us that the Appellant's point that where a Tribunal has found objective knowledge sufficient to deny repayment of input tax as a matter of law, nevertheless that result can, as a matter of law, be reversed by reliance on another Community law principle (equal treatment) is clearly misconceived."

280. Mr Justice Roth J in POWA stated at paragraph 60:

> "As to non-discrimination, this Appeal concerns the decision by HMRC that the objective criteria determining the right to deduct input tax were not met as regards these claims for repayment by PJL. If that is the case, PJL were not entitled to such repayments, irrespective of the position of anyone else. ……Furthermore whether HMRC could have applied a similar approach to the traders who served as buffers in the chains (who would generally not be making a repayment claim to HMRC but simply crediting the input tax against the output tax received) does not affect that conclusion; and whether HMRC should have pursued those traders for an account of the output tax received is a question of policy regarding the effective enforcement of the VAT regime, with no doubt limited resources. Accordingly, I consider that the principle of non-discrimination is not engaged".

281. The Tribunal has found that the Appellants knew that their transactions were connected to fraud. Given that finding the Tribunal is bound by the decisions of the Upper Tribunal which effectively states that such traders are not entitled to rely on another Community Principle to reverse the finding that they have abused their rights to repayment of input tax. The Tribunal considers this principle applied equally to the specific discrimination relied upon by the Appellants in respect of HMRC's treatment of Mediawatch.

282. The Tribunal, however, questions the factual basis of the Appellant's specific allegation of discrimination in the case of the Mediawatch. The facts were that Mediawatch was originally assessed for £10.8 million which was reduced to £8.9 million following the discovery of purchase invoices from Lewis Davis Productions for transactions from 3 April 2006 to 4 May 2006. HMRC's rationale was that Lewis Davis Productions not Mediawatch was the missing trader for these transactions, in which case the tax loss should be re-allocated to the correct missing trader. Given those circumstances HMRC's treatment of Mediawatch was consistent with its policy

of raising assessments against missing traders and denying the input tax claimed by the broker traders. Thus there was nothing distinctive about the Appellants' allegation of specific discrimination. HMRC's decision in respect of Mediawatch was a direct application of its policy which was considered by the Upper Tribunal in *S & I* and *POWA*.

**Decision**

283. The Tribunal finds the following:

(1) There was a VAT loss in each of the Appellants' disputed transactions.

(2) The loss in each of the Appellants' disputed transactions was occasioned by fraud.

(3) Each of the disputed transactions was connected with the fraudulent evasion of VAT.

(4) The Appellants knew at the time of entering the disputed transactions that each of those transactions was connected with the fraudulent evasion of VAT.

284. The Tribunal, therefore, dismisses the Appeal and confirms HMRC denial of input tax in the total sum of £6,715,314.73 claimed in the VAT quarterly accounting periods 04/06, 05/06 and 06/06. in respect of 26 transactions (29deals).[34]

285. The Tribunal invites the parties' representations on the question of costs within 56 days from the date of the decision. According to the Appellants no directions have been made about whether the 1986 or 2009 Rules apply to this Appeal.

286. In the absence of agreement leave is given to parties within 56 days of release to apply for a determination of the amount of the costs order under rule 10(1)(b) of the 2009 Rules and referred to in paragraph 21.

287. 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.

**MICHAEL TILDESLEY OBE**
**TRIBUNAL JUDGE**

**RELEASE DATE: 12 March 2013**

[34] See paragraph 3.