TC02893

Appeal number: LON/2007/01649 & LON/2007/01650

VAT – MTIC – application for disclosure - refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

ABBOTT INTERNATIONAL TRADING LIMITED

STAMILL LIMITED **Appellants**

- and –

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

TRIBUNAL: JUDGE GREG SINFIELD

Application determined on 24 September 2013 without a hearing, each party having agreed that the matter should be dealt with on written submissions only.

DECISION

Introduction

1. These appeals concern an alleged MTIC fraud involving contra-trading which was described by the VAT and Duties Tribunal in *Olympia Technology Ltd v HMRC* [2008] V20570 at [4] – [6] as follows:

> "4. In contra-trading there are, in its simplest theoretical form, two chains of transactions. First, the "dirty chain," in which there is a defaulting trader ("defaulting trader" for short), comprising A (the defaulting trader) who is the importer of goods into the UK, who sells them to B (the buffer company), who sells them to C who exports the goods, and is thus in a VAT reclaim position. (For simplicity we shall use the expressions import and export for intra-Community trade, acknowledging that these are not the proper labels.) Secondly, the "clean chain," in which there are no missing traders, comprising C, who is this time the importer of other goods, who sells to D, who sells to E, the exporter (the Appellant in this appeal is in the position of E in relation to the three alleged contra-trading deals). The effect of the clean chain is that the net input tax position of C in the dirty chain is cancelled by output VAT in the clean chain. There is no direct financial benefit to C in this as C has paid the input tax to B, and therefore C could be in league with the defaulting trader, or could be a trader who is controlled (possibly without knowing it) by a "puppet master" to enter into the cancelling transactions to disguise A's involvement a fraud, or a trader who happens to carry out both import and export transactions unconnected with any fraud,. The effect of the contra-trades is that C does not excite Customs' attention as it is not applying for a repayment; the non-payment of tax by A is less noticeable since without a return Customs do not know how much tax A owes. The input tax reclaim that C had in the dirty chain has moved to E who is at the end of a clean chain. The only way for Customs to refuse repayment of E's input tax is to show that E knew or ought to have known of A's fraud in a completely different chain, and of C's involvement in the fraud.
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> 5. The nature of contra-trading is easy to state in the above way but the problem in real life is that there is no logical connection between the clean and dirty chains. First, the VAT accounting periods for C and E will not coincide; E may be on a monthly accounting period as it is a habitual exporter, but C may be on a three-monthly period, and C need only arrange that the net tax is nil during that three-monthly period by entering into transactions after E's transactions. Secondly, the goods dealt in may be different in the two chains. Thirdly, for a particular C there may be many different equivalents to A and E, and for a particular E there may be many equivalents of C, each with more than one equivalents to A. Fourthly, C may not have deliberately entered into imports in the clean chain in order to cancel the input in the dirty chain; C may merely be both an importer and an exporter whose outputs in relation to the former happen roughly to cancel its inputs in relation to the latter. Fifthly, there may be many Bs and Ds in between the importer and exporters.

> 6. The fraud in a simple MTIC fraud is that the defaulting trader always intends to default. It will normally be the case that he defaults later than the dates the deals in the chains are executed because he fails to pay the tax due for the period in which the deals occur. One of the problems is that C, the exporter in a simple MTIC fraud, is always separated from the defaulting importer by one or more Bs and may not know of the existence of A. If C enters into a deal that is too good to be true it can be said that he ought to know of the fraud even though he does not know of A's identity. In a contra-trading fraud the question is whether E knows or ought to have known that C entered into the clean chain transactions to cover A's intention to default. Again the problem is that E may be separated from C by one or more Ds (although in this case C, the alleged contra-trader sells directly to E, the Appellant)."

2. In this case, the Respondents ("HMRC") alleged that the Appellants were in the position of E in the explanation given by the Tribunal in *Olympia Technology*. HMRC denied the Appellants' claims to deduct input tax on the ground that they knew or ought to have known that they were participating in transactions connected with VAT fraud.

Application for disclosure

3. By an application dated 19 October 2012, the Appellants seek a direction under Rule 5(3)(d) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 requiring HMRC to provide certain documents and information to the Appellants and the Tribunal. The documents and information sought are as follows:

> (1) the submission(s) and accompanying letter(s) from Officer Magnay (or other HMRC Assurance Officers responsible for the Appellants) to the Respondents' Policy Unit recommending denial of input tax on grounds that the Appellants knew or should have known that it was [sic] participating in transactions connected with fraud (whether sent to the Respondents' VAT Fraud Team at 100 Parliament Street, London, SW1 or otherwise);
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> (2) a copy of the response(s) from the Respondents' Policy Unit (VAT Fraud Team or otherwise) to Officer Magnay or other responsible HMRC Assurance Officer(s) for the Appellants;
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> (3) confirmation that the input tax denied to the Appellants in these appeals has not already been recovered, or is being recovered, from any of the other traders and any alleged material chains that are the subject of this appeal; and
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> (4) a copy of all of the Respondents' policy documents in relation to "contra-trading" and the allocation of alleged tax losses.

4. In summary, the Appellants contend that the documents and information reveal HMRC's policy in relation to the allocation of tax losses in cases of MTIC fraud and the extent to which HMRC has recovered VAT elsewhere in the chains of supply with which the appeals are concerned. The Appellants argue that the items sought are relevant to the issues arising in the appeals because, they contend, HMRC cannot deny brokers or exporters in clean chains, such as the Appellants, their right to deduct input tax without

(1) allocating a specific tax loss arising from a specific defaulter to the Appellants' claim for input tax; and

(2) where there is the possibility of double or multiple recovery of VAT by HMRC.

5. The Appellants accept that the Court of Justice of the European Union ("CJEU") held in Joined Cases C-439/04 and C-440/04 *Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL* [2006] ECR I-6161, [2008] STC 1537 ("*Kittel"*)) that, where a taxable person knew or should have known that, in purchasing goods, he was taking part in a transaction connected with the fraudulent evasion of VAT, that taxable person loses the right to deduct input tax on those goods. For the purpose of this application only, the Appellants accept that the *Kittel* principle applies to contra-trading although the Appellants' principal submission in the appeals is that the principle in *Kittel* is limited to one chain of transactions, ie where the fraudulent evasion of VAT is committed in the immediate chain of supply, and does not apply to contra-trades. Essentially, the Appellants' submission is that the rule in *Kittel* does not apply to clean chains in contra-trades.

6. On the basis, for the purposes of this application, that the rule in *Kittel* does apply to a person in a clean contra-chain, the Appellants contend that HMRC cannot deny the Appellants the right to deduct input tax on goods, even if the Appellants purchased the goods with the required knowledge of a connection with VAT fraud, where HMRC have not allocated the amount of the VAT loss to the Appellants' input tax claims and there is a possibility that HMRC might recover the amount of the VAT loss from another taxable person or multiple times from other taxable persons.

7. The Appellants contend that double recovery of the amount of the VAT sought to be defrauded would be contrary to the EU law principles of proportionality, fiscal neutrality and the rule against penalties. There is no doubt about the existence in EU law of general principles of proportionality (see *HMRC v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC) at [18]-[49]) and fiscal neutrality (see Joined Cases C-259/10 and C-260/10 *HMRC v Rank Group plc* [2012] STC 23 at [32]-[35]). The Appellants' submission that there is an EU law rule against penalties relies on a passage from the CJEU's judgment in Case C-255/02 *Halifax and Others v Customs and Excise* at [93]:

> "It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of that finding, which rendered undue all or part of the deductions of input VAT."

8. In *Halifax*, the CJEU contrasted the concept of a penalty with an obligation to repay. The CJEU in *Halifax* did not regard the obligation to repay input tax as a penalty. That was in the context of the CJEU's ruling at [94] that "transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice". The CJEU in *Halifax* did not, in my view, hold that there was any general EU rule against penalties.

9. The CJEU in *Halifax* did not consider the situations of the person who issues an invoice and the person who receives it in the context of a transaction connected with fraud or similar irregularity. The CJEU considered these issues in Case C-643/11 *LVK - 56 EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (31 January 2013). LVK was a Bulgarian company that carried on business as an agricultural producer. LVK claimed to deduct input tax on the purchase of goods from suppliers in Bulgaria. Following an investigation, the Bulgarian tax authorities concluded that it had not been proved that the supply of the goods had taken place. As a result, the tax authorities refused LVK's deduction of input tax. There was no dispute that the suppliers had entered the supplies in their sales ledgers, issued VAT invoices and accounted for VAT. The tax authorities decided that there was no need to adjust the VAT accounted for by the suppliers of the goods. LVK appealed and the matter was eventually referred to the CJEU.

10. The CJEU held, at [42], that Article 203 of Directive 2006/112 means that a person is liable to pay VAT shown by him on an invoice whether or not there was an actual taxable transaction. The CJEU also held that it could not be inferred from the fact that the tax authorities did not correct the VAT declared by the supplier that those authorities have accepted that there was an actual taxable transaction.

11. The CJEU then considered whether EU law (specifically, Articles 167 and 168(a) of Directive 2006/112 and the principles of fiscal neutrality, legal certainty and equal treatment) precludes a recipient of an invoice, such as LVK, from being refused the right to deduct input tax where the supplier had accounted for the VAT shown on the invoice and the tax authority had not made any adjustment of the supplier's VAT liability. The CJEU held at [46] - [50] as follows:

> "46 So far as concerns the treatment of VAT that has been improperly invoiced because there is no taxable transaction, it follows from Directive 2006/112 that the two traders involved are not necessarily treated identically in so far as the issuer of the invoice has not corrected it …
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> 47 On the one hand, the issuer of an invoice is liable to pay the VAT entered on that invoice even if there is no taxable transaction, in accordance with Article 203 of Directive 2006/112. On the other hand, exercise of the right of deduction by the recipient of an invoice is limited solely to tax corresponding to a transaction subject to VAT, in accordance with Articles 63 and 167 of that directive.
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> 48 In such a situation, compliance with the principle of fiscal neutrality is ensured by the possibility, to be provided for by the Member States and noted in paragraph 37 above, of correcting any tax improperly invoiced where the issuer of the invoice shows that he acted in good faith or where he has, in sufficient time, wholly eliminated the risk of any loss of tax revenue.
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> ...
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> 50 It follows that Articles 167 and 168(a) of Directive 2006/112 and the principle of fiscal neutrality do not preclude the recipient of an

> invoice from being refused deduction of input VAT because there is no taxable transaction, even though, in the tax adjustment notice addressed to the issuer of the invoice, the VAT declared by the latter was not adjusted."

The CJEU also concluded that the principles of legal certainty and equal treatment did not prevent the different treatment of the supplier and recipient of the supply.

12. Paragraphs [46] - [50] establish that double or multiple recovery of VAT is not precluded by Directive 2006/112 or the principle of fiscal neutrality. Paragraph [48] clearly states that, in cases where there was no supply, the taxable person who issued the invoice must show that he acted in good faith or has, wholly eliminated the risk of any loss of tax before there must be any correction of the VAT improperly invoiced. Paragraph [50] shows that there is no requirement to reconcile related output and input transactions by different taxable persons where there is an irregularity. I consider that it follows that there is no rule that a tax authority must allocate a specific output tax loss to a particular input tax claim.

13. At [58] – [60], the CJEU considered the position of the person claiming deduction of input tax in cases of fraud or abuse and held as follows:

> "58 … it is true that preventing possible tax evasion, avoidance and abuse is an objective recognised and encouraged by Directive 2006/112 and European Union law cannot be relied on for fraudulent or abusive ends (see, inter alia, Case C-255/02 *Halifax and Others* [2006] ECR I-1609, paragraphs 68 and 71; Joined Cases C-80/11 and C-142/11 *Mahagében and Dávid* [2012] ECR I-0000, paragraph 41; and *Bonik*, paragraphs 35 and 36).
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> 59 It is therefore incumbent upon the national authorities and courts to refuse the right of deduction where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent or abusive ends (see, to that effect, Joined Cases C-439/04 and C-440/04 *Kittel and Recolta Recycling* [2006] ECR I-6161, paragraph 55; *Mahagében and Dávid*, paragraph 42; and *Bonik*, paragraph 37).
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> 60 Nevertheless, according to case-law that is also well-established, it is incompatible with the rules governing the right of deduction under Directive 2006/112 to impose a penalty, in the form of refusal of that right, on a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud committed by the supplier, or that another transaction forming part of the chain of supply prior or subsequent to the transaction carried out by the taxable person was vitiated by VAT fraud (see, inter alia, Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen and Others* [2006] ECR I-483, paragraphs 52 and 55; *Kittel and Recolta Recycling*, paragraphs 45, 46 and 60; *Mahagében and Dávid*, paragraph 47; and *Bonik*, paragraph 41)."

14. Paragraph [60] of *LVK* makes it clear that a refusal of the right to deduct input tax in the context of transactions connected with VAT fraud is a penalty. The CJEU stated that the imposition of such a penalty on a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud is

incompatible with Directive 2006/112. The CJEU did not hold that that there was a general EU rule against penalties. Indeed, it is implicit in paragraph [60] of *LVK* that the imposition of such a penalty on a taxable person who knew or ought to have known that the transaction was connected with fraud is compatible with the VAT Directive.

15. My conclusion, based on *LVK*, is that the Appellants' submission that HMRC cannot deny the Appellants' right to deduct input tax on goods without allocating the amount of the VAT loss to the Appellants' input tax claims and notwithstanding the possibility of double or multiple recovery of the VAT loss is unsustainable. It follows that the documents that relate to those issues and in respect of which the Appellants seek disclosure are not relevant to the appeals. Accordingly, I refuse the Appellants' application.

16. For completeness, I will deal with HMRC's submissions briefly. HMRC oppose the application and contend that that material requested is not relevant to the issues in the appeals. HMRC submit that the contents of the officer's submission to the Policy Unit and/or any response are irrelevant to the issues that the Tribunal must consider in the appeal, namely whether:

(1) there has been a fraudulent evasion of VAT;

(2) the Appellants' transactions in relation to which input tax has been denied were connected with that fraudulent evasion of VAT , and

(3) the Appellants knew or should have known that the transactions were connected with the fraudulent evasion of VAT

17. In relation to the issue of double or multiple recovery of the tax loss, HMRC submit that there is no principle which requires HMRC to allow input tax deduction in relation to a transaction connected with fraud, assuming the taxable person had the requisite knowledge or deemed knowledge, to the extent that HMRC has or will or might recover the loss from another taxable person.

18. Had I decided that the issue of allocation of specific VAT losses to the Appellants' input tax claims was relevant then I would have directed HMRC to produce policy documents that related to the allocation. As stated above, I do not consider that allocation is relevant and, therefore, make no such direction. In any event, I would not have directed that HMRC provide all "submission(s) and accompanying letter(s)" to HMRC Policy recommending denial of input tax or all responses from HMRC Policy as this would go far beyond the issues identified by the Appellants and would not, in my view, be evidence in relation to the issues in the appeal but would merely be evidence of the opinion of certain HMRC officers at a particular time.

19. As to the issue of double recovery, if I had not concluded that *LVK* establishes that there is no EU rule prohibiting double or multiple recovery of VAT in cases of fraud then I would still not have directed production of documents or information because binding UK case-law compels me to the same conclusion. Moses LJ in

Mobilx Limited (In Administration) and others v HMRC [2010] EWCA Civ 517, [2010] STC 1436 observed at [65]:

> "The *Kittel* principle is not concerned with penalty. It is true that there may well be no correlation between the amount of output tax of which the fraudulent trader has defrauded HMRC and the amount of input tax which another trader has been denied. But the principle is concerned with identifying the objective criteria which must be met before the right to deduct input tax arises. Those criteria are not met, as I have emphasised, where the trader is regarded as a participant in the fraud. No penalty is imposed; his transaction falls outwith the scope of VAT and, accordingly, he is denied the right to deduct input tax by reason of his participation."

Decision

For the reasons given above, I refuse the Appellants' application for a direction that HMRC must provide the documents and information specified in [3] above.

GREG SINFIELD

TRIBUNAL JUDGE

RELEASE DATE: 24 September 2013