



**TC03861**

**Appeal number: LON/2008/0457  
LON/2008/0682  
LON/2007/1677**

*VALUE ADDED TAX – input tax – denial of right to deduct on grounds that the Appellant knew or should have known that the transaction was part of fraud by others – alleged MTIC – whether shown that the Appellant’s transactions connected with fraudulent evasion of VAT – yes – whether Appellant “knew or should have known” of fraud – yes – valid refusal of right to deduct – appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**GANDALF IT LIMITED (IN LIQUIDATION)  
GANDALF ASIA LIMITED (IN LIQUIDATION)  
SIRRNET LIMITED (IN LIQUIDATION)**

**Appellant**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY’S  
REVENUE & CUSTOMS**

**Respondents**

**TRIBUNAL: JUDGE JENNIFER BLEWITT  
MR DAVID E. WILLIAMS CTA (Fellow)**

**Sitting in public at Bedford Square on 17, 18, 21, 22, 24, 25 and 30 October 2013**

**Mr Robert Holland of Dass Solicitors for the Appellant**

**Mr Sailesh Mehta leading Ms Karen Robinson and Mr Jamie Sharma, Counsel instructed on behalf of HM Revenue and Customs, for the Respondents**

## DECISION

### Introduction

5

1. These conjoined appeals arise from HMRC's decisions contained in letters to Gandalf IT Ltd (hereafter "Gandalf IT"), Gandalf Asia Ltd (hereafter "Gandalf Asia") and SIRRNET Ltd (hereafter "SIRRNET") in which HMRC refused payment of input tax in the following sums and for the following VAT periods:

10

- £1,122,694.83 claimed by Gandalf IT in respect of 5 transactions in 04/06 which was denied by letter dated 1 February 2008 (and amended by letters dated 20 June 2009 and 25 March 2011);

15

- £1,077,989.76 claimed by Gandalf IT in respect of 3 transactions in 05/06 which was denied by letter dated 1 February 2008 (and amended by letters dated 20 June 2009 and 25 March 2011);

- £919,443.24 claimed by Gandalf Asia in respect of 5 transactions in 06/06 which was denied by letter dated 10 March 2008 (and amended by letter dated 1 June 2009);

20

- £745,290 claimed by SIRRNET in respect of 6 transactions in 04/06 which was denied by letter dated 4 May 2007;

- £3,226,524.80 claimed by SIRRNET in respect of 13 transactions in 05/06 which was denied by letter dated 2 January 2009; and

- £297,675 claimed by SIRRNET in respect of 1 transaction in 06/06 which was denied by letter dated 19 February 2009.

25

2. HMRC's case, as set out in its Statement of Case, is that that the transactions were connected with the fraudulent evasion of VAT and that the Appellants knew or should have known of this fact.

30

3. By Notices of Appeal dated 25 February 2008 and 18 March 2008 respectively Gandalf IT and Gandalf Asia appealed against the decisions. The grounds of appeal were set out in identical terms and can be summarised as follows:

- The transactions cannot be said to be connected with the fraudulent evasion of VAT;

- The Appellants did not know, nor should they have known, that by their purchases they were implicated in a fraudulent transaction; and

35

- That HMRC's decisions were irrational, in breach of the Sixth VAT Directive and offended against the principle of neutrality.

4. Sirrnet appealed against the decisions dated 4 May 2007, 2 January 2009 and 19 February 2009 by Notices of Appeal respectively dated 25 September 2007, 20 January 2009 and 10 March 2009. The grounds of appeal reiterated those relied upon by Gandalf IT and Gandalf Asia.

## 5 Missing Trader Intra-Community Fraud: Legislation and Case law

5. Domestic legislation governing the right to deduct is contained within Sections 24 – 26 of the Value Added Tax Act 1994 and the VAT Regulations 1995 (SI 1995/2518). If a trader has incurred input tax which is properly allowable, he is entitled to set it against his output tax liability or to receive a repayment if the input tax credit due to him exceeds that liability. Evidence is required in support of a claim (Article 18 of the Sixth Directive and regulation 29 (2) of the VAT Regulations 1995).

6. A helpful description of Missing Trader Intra-Community Fraud, hereinafter referred to as “MTIC fraud”, can be found in the judgment of Christopher Clarke J *Red 12 Trading Ltd v HMRC* [2009] EWHC 2563 (Ch):

*“This case concerns what is called "Missing Trader Intracommunity Fraud" ("MTIC fraud"). Anyone reading this judgment is likely to be familiar with this expression, which has been explained in several tribunal and High Court decisions. The classic way in which the fraud works is as follows. Trader A imports goods, commonly computer chips and mobile telephones, into the United Kingdom from the European Union ("EU"). Such an importation does not require the importer to pay any VAT on the goods. A then sells the goods to B, charging VAT on the transaction. B pays the VAT to A, for which A is bound to account to HMRC. There are then a series of sales from B to C to D to E (or more). These sales are accounted for in the ordinary way. Thus C will pay B an amount which includes VAT. B will account to HMRC for the VAT it has received from C, but will claim to deduct (as an input tax) the output tax that A has charged to B. The same will happen, mutatis mutandis, as between C and D. The company at the end of the chain – E – will then export the goods to a purchaser in the EU. Exports are zero-rated for tax purposes, so Trader E will receive no VAT. He will have paid input tax but because the goods have been exported he is entitled to claim it back from HMRC. The chains in question may be quite long. The deals giving rise to them may be effected within a single day. Often none of the traders themselves take delivery of the goods which are held by freight forwarders.*

*The way that the fraud works is that A, the importer, goes missing. It does not account to HMRC for the tax paid to it by B. When HMRC tries to obtain the tax from A it can neither find A nor any of A's documents. In an alternative version of the fraud (which can take several forms) the fraudster uses the VAT registration details of a genuine and innocent trader, who never sees the tax on the sale to B, with which the fraudster makes off. The effect of A not accounting for the tax to HMRC means that HMRC does not receive the tax that it should. The effect of the exportation at the end of the chain is that HMRC pays out a sum, which represents the total sum of the VAT payable down the chain, without having received the major part of the overall VAT due,*

*namely the amount due on the first intra-UK transaction between A and B. This amount is a profit to the fraudsters and a loss to the Revenue.”*

7. The starting point in this type of case is *Kittel v Belgium, Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04) [2006] ECR I-6161 (“*Kittel*”) which  
5 provided the legal basis for the denial of the right to deduct in certain circumstances:

“55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively ... It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for  
10 fraudulent ends...”

56. In the same way, 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.

15 57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

59. Therefore, 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  
20 ‘economic activity’.  
25

60. It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void – by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller – causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to  
30 other fraud.  
35

61. By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct.”

40 8. The case of *Kittel* extended the concept of knowledge to include a trader who ought to have known that there was a fraud and the test was further clarified by *Moses*

LJ in *Mobilx Ltd and The Commissioners for Her Majesty's Revenue and Customs, The Commissioners for Her Majesty's Revenue and Customs and Blue Sphere Global Ltd, Calltel Telecom Ltd & another and The Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517 (“*Mobilx*”) at [24]:

- 5 “The scope of VAT is identified in Art. 2 of the Sixth Directive. It applies, in addition to importation, to the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such. A taxable person is defined in Art. 4.1 as a person who carries out any of the economic activities specified in Art. 4.2. Art. 5 defines the supply of goods and Art. 6 the supply of services. The  
10 scope of VAT, the transactions to which it applies and the persons liable to the tax are all defined according to objective criteria of uniform application. The application of those objective criteria are essential to achieve:-
- 15 “the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional circumstances, to the objective character of the transaction concerned.” (*Kittel* para 42, citing *BLP Group* [1995] ECR1/983 para 24.)

And at [30]:

- 20 “...the Court made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met.”

9. There are now numerous cases which have identified and approved the  
25 following questions as those to be determined in this type of appeal:

- Was there a tax loss;
- If so, did this loss result from a fraudulent evasion;
- If so, were the Appellant's transactions which are the subject of appeal connected with that fraudulent evasion; and
- 30 • If so, did the Appellant know or should it have known that its transactions were so connected.

10. As to the issue of connection, in *Blue Sphere Global Ltd and The Commissioners for HM Revenue and Customs* [2009] EWHC 1150 (Ch) the Chancellor stated (at paragraphs 42 – 45):

- 35 “...The nature of any particular necessary connection depends on its context, for example electrical, familial, physical or logical. The relevant context in this case is the scheme for charging and recovering VAT in the member states of the EU. The process of off-setting inputs against outputs in a particular period and accounting for the difference to the relevant revenue authority can connect two or more transactions

or chains of transaction in which there is one common party whether or not the commodity sold is the same. If there is a connection in that sense it matters not which transaction or chain came first. Such a connection is entirely consistent with the dicta in *Optigen* and *Kittel* because such connection does not alter the nature of the individual transactions. Nor does it offend against any principle of legal certainty, fiscal neutrality, proportionality or freedom of movement because, by itself, it has no effect.

Given that the clean and dirty chains can be regarded as connected with one another, by the same token the clean chain is connected with any fraudulent evasion of VAT in the dirty chain because, in a case of contra-trading, the right to reclaim enjoyed by C (*Infinity*) in the dirty chain, which is the counterpart of the obligation of A to account for input tax paid by B, is transferred to E (*BSG*) in the clean chain. Such a transfer is apt...to conceal the fraud committed by A in the dirty chain in its failure to account for the input tax received from B.”

11. On the issue of knowledge, Moses LJ in *Mobilx* provided the following guidance:

“4. Two essential questions arise: firstly, what the ECJ meant by "should have known" and secondly, as to the extent of the knowledge which it must be established that the taxpayer had or ought to have had: is it sufficient that the taxpayer knew or should have known that it was more likely than not that his purchase was connected to fraud or must it be established that he knew or should have known that the transactions in which he was involved were connected to fraud?

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

53. Perhaps of greater weight is the challenge based, in *Mobilx* and *BSG*, on HMRC's denial of the right to deduct on the grounds that the trader knew or should have known that it was more likely than not that transactions were connected to fraud. The question arises in those appeals as to whether that is sufficient or whether, as the Chancellor concluded in *BSG*, the right to deduct input tax may only be denied where the trader knows or should have known that the transaction was connected to fraud (see judgment, § 52). In short, does a trader lose his entitlement to deduct if he knew or should have known of a risk that his transaction was connected to fraudulent evasion of VAT? HMRC contends that the right to deduct may be denied if the trader merely knew or should have known that it was more likely than not that by his purchase he was participating in such a transaction. It contends that if it was necessary to show more than appreciation of a risk then the Court's decision in *Kittel* would not represent a development of the law and would fail to achieve the objective,

recognised in the Sixth Directive, to which the Court referred at § 54...

56. It must be remembered that the approach of the court in *Kittel* was to enlarge the category of participants. A trader who should have known that he was running the risk that by his purchase he might be taking part in a transaction connected with fraudulent evasion of VAT, cannot be regarded as a participant in that fraud. The highest it could be put is that he was running the risk that he might be a participant. That is not the approach of the Court in *Kittel*, nor is it the language it used. In those circumstances, I am of the view that it must be established that the trader knew or should have known that by his purchase he was taking part in such a transaction, as the Chancellor concluded in his judgment in *BSG*:-

15           □ "The relevant knowledge is that *BSG* ought to have known by its purchases it was participating in transactions which were connected with a fraudulent evasion of VAT; that such transactions might be so connected is not enough." (§ 52)...

58. As I have endeavoured to emphasise, the essence of the approach of the court in *Kittel* was to provide a means of depriving those who participate in a transaction connected with fraudulent evasion of VAT by extending the category of participants and, thus, of those whose transactions do not meet the objective criteria which determine the scope of the right to deduct. The court preserved the principle of legal certainty; it did not trump it.

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.

61. Such an approach does not infringe the principle of legal certainty. It is difficult to see how an argument to the contrary can be mounted in the light of the decision of the court in *Kittel*. The route it adopted was designed to avoid any such infringement. A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe

*that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct.”*

- 5 12. We adopted the approach advocated by Christopher Clarke J in *Red 12 Trading Ltd*, cited with approval by Moses LJ in *Mobilx*, that the purpose of having regard to the attendant circumstances and context of a transaction was in order to understand the true nature of the transaction, not to alter it at [109] – [111]:

10 *“Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of*  
15 *an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and 'similar fact' evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.*

*To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular,*  
20 *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*  
25 *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*  
30 *been obviously honest in thousands.*

*Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them”.*

- 35 13. We noted the concerns raised on behalf of the Appellants that HMRC had collated evidence over a number of years and after the periods which form the subject of these appeals. This issue was addressed in *Red 12* at [89], [90] and [104]:

40 *“...HMRC may, for instance, discover that the taxpayer has been a participant in a series of transactions with extremely long chains. The length of those chains may itself be a powerful, albeit not conclusive, factor in showing that there is fraud. It would be unacceptable for HMRC to be denied the right to prove those chains if the taxpayer claimed (possibly wrongly) that he knew nothing about the participants in*



the chain other than his supplier and customer. Such a rule would also place a premium on wilful blindness. A taxpayer who studiously avoided any inquiries which, had he made them, would have shown him that there was fraud, should not be allowed to deny the authorities the ability to establish the fraud by asserting total ignorance of, and an inability to refute, the facts that establish it. There could also be much scope for debate as to whether such evidence was "irrefutable", given that the taxpayer can seek to adduce evidence from any or all of the participants in the chain of their good faith.

10 It is important to remember that the right to deduct input tax cannot be denied unless HMRC establishes the requisite knowledge (actual or constructive) on the part of the taxpayer. Proof of facts unknown to the taxpayer as part of the proof of fraud will not itself disentitle the taxpayer to a refund. Proof of knowledge (actual or constructive) must, by definition, be proof of what the taxpayer knew or which, had he used reasonable precautions, he ought to have known. He will be able to give evidence of what he knew and what checks he made; and thus, if he can, to refute the allegations of knowledge made against him

20 If the tribunal may only consider evidence that was before HMRC when it made its decision there would be a risk of unfairness (quite apart from wasted cost) to both sides if the appeal could be dismissed or allowed despite the availability of exculpatory or incriminating evidence. In the present case, as the Tribunal pointed out, most of the evidence of Red 12's due diligence was produced after HMRC's decision. Further HMRC are under a duty to keep investigations under review: per 25 *Lightman J in R (UK Tradecorp) Ltd v HMRC [2005] STC 138 at para 18....*"

14. That the onus and burden of proof in this type of case rests with HMRC was confirmed by Moses LJ in *Mobilx* (paragraph 81):

30 "It is plain that if HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion."

15. Our approach to the appeals was to recognise that, while we must consider the merits of the individual transactions, we should not view the transactions in isolation. We were cautious to ensure that in considering the knowledge of the Appellants we only took account of information known to them during the relevant periods but that 35 did not prevent HMRC, or indeed the Appellants, from adducing evidence gathered after the periods with which we are concerned.

16. We were also referred to a number of CJEU judgments including, inter alia, *Stroy Trans EOOD* Case C-642/11 ("*Stroy*") and *Mahageben Kft and another* ("*Mahageben*") Case C-80/11 and C-142/11 and *LVK-56 EOOD* Case C-643/11 40 ("*LVK*"). In summary, it was submitted on behalf of the Appellants that well-established legal principles of common law, when taken together with CJEU case law support the contention that for the benefit of the right to deduct to be lost, HMRC must demonstrate objective factors relating to the impugned transactions of which the Appellant knew or should have known at the time of entering into the said

5 transactions. Furthermore, the Appellants submitted that HMRC had an obligation to make enquiries into any matters which it considered irregular or fraudulent and take action. The failure by HMRC to do so cannot transfer the obligation onto the Appellants as to do so would infringe the principles of proportionality and legitimate expectation. The evidence adduced by HMRC in this case does not constitute objective factors by which the Appellants can be denied the right to deduct and a distinction should be drawn between “objective factors” and “objective criteria.”

10 17. We agreed with the submissions advanced by HMRC that there is a distinction to be drawn between the terms “objective criteria” and “objective factors”. “Objective criteria” is referable to the existence of the right to deduct within the common VAT system. The entitlement to the right to deduct may be refused based on the state of the Appellants’ knowledge, which is to be determined by the Tribunal’s assessment of “objective factors.” We had regard to *Mobilx* in which it was stated:

15 *“41. In Kittel after § 55 the Court developed its established principles in relation to fraudulent evasion. It extended the principle, that the objective criteria are not met where tax is evaded, beyond evasion by the taxable person himself to the position of those who knew or should have known that by their purchase they were taking part in a transaction connected with fraudulent evasion of VAT:-*

20 *□ “56. In the same way, 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. □*

25 *57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice. □*

*58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.”*

30 *□ 59. Therefore, 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*  
35 *concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'. [emphasis added]” □*

40 *The words I have emphasised "in the same way" and "therefore" link those paragraphs to the earlier paragraphs between 53-55. They demonstrate the basis for the development of the Court's approach. It extended the category of participants who fall outwith the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. Kittel did represent a*

development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct.

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

18. We were satisfied that none of the recent CJEU authorities relied on by the Appellants change or restrict the *Kittel* principles, which were thoroughly analysed and confirmed in *Mobilx*. We were also satisfied that the same authorities did not impose a “threshold” test which had to be met before the Appellants were under any obligation to make their own enquiries; we accepted the submission of Counsel for HMRC that the principles set out in *Kittel* and *Mobilx* do not require a taxpayer to take on HMRC’s investigative role, but merely to take such reasonable steps as any commercially minded businessman would take to protect himself from fraud. We therefore proceed on the basis that the decision in *Mobilx* remains binding upon us and the test which we must apply, as set out in *Kittel* and *Mobilx*, does not infringe the principles of legitimate expectation or proportionality.

19. Mr Holland made brief submissions on the issue of discrimination, noting that the argument may be more suitable for judicial review proceedings. However, it having been raised we will address the issue in short. It was argued on behalf of the Appellants that the evidence of HMRC officers Cummins and Yeomans acknowledged that there was a departmental policy to only apply the test of knowledge against broker traders despite HMRC’s view that other traders in the chains of supply were participants in the contrived schemes. Mr Holland submitted that this evidence constituted an admission of discrimination against broker traders.

20. In our view HMRC’s policies, or the merits of pursuing the point elsewhere, are not matters upon which we must reach any conclusions. These appeals are concerned with the Appellants’ entitlement to deduct input tax. Whether or not such a policy existed within HMRC or the propriety of such a policy has no bearing on our decision. We are therefore satisfied that the issue of discrimination does not arise in the context of this appeal.

### **A Summary of the Parties and Evidence**

21. Mr Sailesh Mehta leading Ms Karen Robinson and Mr Jamie Sharma of Counsel appeared on behalf of HMRC. Mr Robert Holland of Dass Solicitors appeared on behalf of the Appellants. We were provided with a significant number of lever arch files containing witness statements and documentary exhibits relied upon by both parties. We also took evidence from the following witnesses:

- Ms Verna Gellvear, an HMRC officer who was responsible for the decision to deny Sirnnet’s repayment claims;
- 5 • Mr Harold Kenneway, an HMRC officer who provided evidence relating to money flows involving First Curacao International Bank (FCIB) in the Netherlands Antilles
- Ms Julie Yeomans, an HMRC officer who was responsible for the decision to deny Gandalf IT and Gandalf Asia’s repayment claims;
- Mr Michael Kerrigan, an HMRC officer who provided evidence relating to Operation Apparel;
- 10 • Ms Karen Cummins, an HMRC officer who provided evidence relating to Operation Apparel;
- Mr Vincent D’Rozario, an HMRC officer who provided evidence relating to buffer trader Syskal Distribution Limited;
- 15 • Mr Peter Davies, an HMRC officer who provided evidence relating to defaulting trader Anfell Traders Ltd;
- Mr Stewart Yule, an HMRC officer who provided evidence relating to defaulting trader Skywide Ltd;
- Mr Anthony Mullarkey, an HMRC officer who provided evidence relating to defaulting trader Knightswood;
- 20 • Mr Gary Saul, an HMRC officer who provided evidence relating to defaulting trader SS Enterprises;
- Mr Eran Milner, Intel Corporation Compliance and Fraud Investigations Manager who gave evidence regarding CPUs;
- 25 • Ms Margaret Pearson, an HMRC officer who gave evidence relating to Fonedealers
- Ms Nicola Leak, an HMRC officer who gave evidence relating to defaulting and buffer trader MG Components;
- Mr Llion Rowlands, shareholder in Gandalf IT, Gandalf Asia and Sirnnet;
- 30 • Mr Abraham Jacob Lionel Van Praagh; main board director of Highwater Properties Limited (“Highwater”) and director of Gandalf Asia, Gandalf IT and Sirnnet.

22. It may also be helpful at this point to set out the various shareholdings and directorships of those involved in the Appellant companies:

<b>Company</b>	<b>Date</b>	<b>Name</b>	<b>Position</b>
Gandalf IT	21 October 2003 to 29 April 2005	Richard Dawson	Director
	From 29 April 2005	Wendy Evans	Director & 5% shareholder
	From 27 June 2005 to 14 August 2006	Tobias Rose	Co Secretary
		Highwater	14% shareholder
		Llion Rowlands	48% shareholder
	From 14 August 2006 to 1 October 2007	Alan Gould & Kelly Stewart	Joint 33% shareholders
Mark Pickering		Co Secretary	
Gandalf Asia	3 June 2004 to 29 April 2005	Richard Dawson	Director
	From 29 April 2005	Wendy Evans	Co Secretary, Director & 5% shareholder
	From 27 June 2005 to 14 August 2006	Tobias Rose	
		Alan Gould	15% shareholder
		Highwater	15% shareholder
		Llion Rowlands & Kelly Stewart	50% shareholder 15% shareholder
	Mark Pickering		

	From 14 August 2006 1 October 2007		Co Secretary
Sirnet		Igor Rogelj Stephen Ryder Alan Gould Igor Rogelj Llion Rowlands Kelly Stewart	Director Co. Secretary 23% shareholder 10% shareholder 45% shareholder 22% shareholder
Syskal		Llion Rowlands Mark Pickering Alan Gould Llion Rowlands Kelly Stewart	Director Director Co. Secretary & 25% shareholder 50% shareholder 25% shareholder
Multisystems International Ltd	25 July 2002 to date	Richard Dawson	Director
Multisystems Global Ltd	13 October 2004 to date	Richard Dawson	Director
Multisystems Technology Ltd	30 June 2005 to date	Richard Dawson	Director
Manatlantic Ltd		Igor Rogelj Stephen Ryder	Director Company Secretary and sole shareholder

## Issues

23. It was accepted on behalf of the Appellants by letter dated 25 June 2013 that HMRC had established that the following companies were fraudulent defaulting traders:

- Attic Attack UK Ltd;
- 5 • Causeway Initiatives Ltd;
- Tressle Limited
- SS Enterprises GB Ltd (“SS Enterprises”);
- Anfell Traders Ltd;
- I Sales London Ltd;
- 10 • Skywide Ltd;
- Fonedealers Ltd;
- KEP 2004 Ltd; and
- Knightswood Ltd

24. It was also accepted that fraudulent tax losses connected to the Appellants’ transactions have been assessed against all of the traders listed above save for Fonedealers Ltd and Knightswood Ltd.

25. The letter also stated “*Our clients accept that the Commissioners have traced all of the deal chains involving Gandalf IT Limited and Gandalf Asia Limited. They also accept that the Commissioners have traced the chains in which Sirrnet was involved in April and June 2006.*”

26. In written opening submissions the Appellants made further similar admissions in respect of fraudulent tax losses connected to the Appellants’ transactions in respect of:

- Causeway Initiative Ltd;
- 25 • Okeda;
- Tressle Ltd;
- KEP 2004 Ltd;
- I Sales London Ltd; and
- Attic Attack.

27. During the hearing the Appellant also released the HMRC officer Mr David Taylor who provided evidence in respect of defaulting trader Swindon Star who had initially been required to give evidence.

28. There was some challenge to HMRC's tracing of deal chains in this case, which we will outline in due course. However the principal issue for the Tribunal to determine was whether the Appellants knew or should have known that their transactions were connected with fraud.

### **Undisputed Background Facts**

#### *Gandalf IT*

29. Gandalf IT is a limited liability company which was incorporated on 21 October 2003. The VAT1 declared its current and/or intended business activity as "the international trade of IT hardware" and that regular repayments of VAT were expected. The value of goods likely to be bought from or sold to other EC member states over the following 12 months was declared as nil. The company was registered for VAT on 22 October 2003 and rendered quarterly returns until March 2006. Attached to the VAT1 was a letter of intent from Syskal Distribution Ltd ("Syskal"), which was stated to be one of Gandalf IT's main customers. The letter was signed by Llion Rowlands, a director of Syskal and it indicated that if Gandalf IT should be in a position to supply Syskal with Cisco networking products, the companies would trade with each other.

30. The company's principal place of business was Gainsborough House, Richmond, Surrey. At the time of its application to register for VAT the sole director was Mr Richard Dawson, who was also the director of Multisystems International Ltd. On 26 May 2006 Ms Wendy Evans notified HMRC that she had taken over as director of Gandalf IT following Mr Dawson's resignation on 29 April 2005. HMRC officers visited the business on 1 September 2006 and were told by Ms Evans that she had previously been involved in the business as a management assistant and that Mr Dawson had resigned to concentrate on his other businesses.

31. On 6 October 2006 Gandalf IT went into administration.

32. The turnover of Gandalf IT as shown on its VAT returns was as follows:

<b>VAT PERIOD</b>	<b>NET TURNOVER (£)</b>	<b>VAT PERIOD</b>	<b>NET TURNOVER (£)</b>
03/04	467,008	05/05	3,412,985
04/04	2,101,952	06/05	940,775
05/04	853,722	07/05	3,364,099
06/04	338,471	08/05	2,692,847



07/04	2,831,201	09/05	4,702,214
08/04	2,180,593	10/05	4,152,541
09/04	676,811	11/05	5,161,131
10/04	1,937,622	12/05	1,901,714
11/04	347,303	01/06	751,126
12/04	0	02/06	600
01/05	697,702	03/06	436,821
02/05	1,219,723	04/06	6,640,195
03/05	396,642	05/06	6,325,535
04/05	0	06/06	2,060

33. Up until April 2006 the deal logs submitted by the Company to HMRC showed the business activities as the buying and selling of IT products such as CPUs.

5 34. The VAT returns submitted by Gandalf IT for the monthly periods ending 30 April 2006 and 31 May 2006 were selected for extended verification due to the large repayment claims made. The Company was notified by letters dated 26 May 2006 and 21 June 2006 respectively.

#### *Gandalf Asia*

10 35. Gandalf Asia is a limited liability company which was incorporated on 3 June 2004 and registered for VAT with effect from 15 June 2004. The VAT1 declared the current and/or intended business activity to be "IT hardware supply and consultancy exports." The Company expected to receive regular VAT repayments and the value of goods likely to be bought from or sold to other EC member states over the following 12 months was declared as nil.

15 36. The company's principal place of business was Gainsborough House, Richmond, Surrey. At the time of its application to register for VAT the sole director was Mr Richard Dawson. On 29 April 2005 Ms Wendy Evans took over as director on the resignation of Mr Dawson.

37. The Company went into administration on 6 October 2006.

20 38. The turnover of Gandalf Asia as shown on its VAT returns was as follows:

<b>VAT PERIOD</b>	<b>NET TURNOVER (£)</b>	<b>VAT PERIOD</b>	<b>NET TURNOVER (£)</b>
08/04	358,711	08/05	1,564,659
09/04	254,592	09/05	2,150,966
10/04	0	10/05	1,133,520
11/04	0	11/05	4,033,837
12/04	0	12/05	0
01/05	128,520	01/06	1,373,980
02/05	0	02/06	0
03/05	0	03/06	1,058,715
04/05	0	04/06	0
05/05	0	05/06	2,403,765
06/05	0	06/06	5,410,470
07/05	1,211,288		

39. Up until April 2006 the deal logs submitted by the Company to HMRC showed the business activities as the buying and selling of IT products such as CPUs.

5 40. The VAT return submitted by Gandalf Asia for the monthly period ending 30 June 2006 was selected for extended verification due to the large repayment claim made. The Company was notified by letter dated 25 July 2006.

*Sirynet*

10 41. Sirynet is a limited liability company which was incorporated on 13 July 2004. Its trade classification at Companies House is “wholesale of mining construction and civil engineering machinery.” The Company was registered for VAT with effect from 23 August 2004. The VAT1 signed on 9 September 2004 declared the intended business activity to be “export of computer networking products, mainly CISCO computer hardware to the USA.” The Company did not expect to buy from or sell to another EC member state over the following 12 months and the anticipated turnover 15 in that period was £400,000. Monthly returns were rendered from 30 November 2004.

42. The Company’s principal place of business during the relevant period was Regents Place, 338 Euston Road, London. The company director at the time of the

transactions which form the subject of this appeal was Mr Igor Rogelj who was appointed on 13 July 2004. The company secretary at the relevant time was Stephen Ryder who was appointed on the same date. Mr Rogelj and Mr Ryder were also director and company secretary respectively of a company called Manatlantic Ltd.

5 43. The turnover of the Company as shown on its VAT returns was £14.4 million between January 2005 and August 2005. Between December 2005 and May 2006 the turnover increased to £29.4 million.

44. The Company went into administration on 6 October 2006.

10 45. The VAT returns submitted by Sirrnet for the monthly periods ending 30 April 2006, 31 May 2006 and 30 June 2006 were selected for extended verification due to the large repayment claims made; the Company was notified by letters dated 24 August 2006, 21 June 2006 and 25 July 2006 respectively.

### Transactions connected to fraudulent tax losses

#### *Gandalf IT*

15 46. No issue was taken by the Appellants as to HMRC's tracing of the chains of supply of Gandalf IT's 5 deals in 04/06 or 3 deals in 05/06. Nor was it disputed that the chains were traced back to fraudulent tax losses. In those circumstances we will only briefly outline the relevant transactions of Gandalf IT.

20 47. 8 deals were carried out by the Company in April and May 2006; all involved mobile phones save for deal 6 which involved CPUs. All, with the exception of one deal, were traced to the defaulter SS Enterprises which was the UK acquirer. In the 7 deals traced back to SS Enterprises, the Appellant's immediate supplier was Syskal, which in turn was supplied by Multisystems Technology Ltd.

48. The relevant deals were as follows:

Deal No:	Deal 1	Deal 2	Deal 3 a	Deal 3b	Deal 4	Deal 5	Deal 6	Deal 7	Deal 8
<b>Date</b>	28 April 2006	28 April 2006	28 April 2006	28 April 2006	28 April 2006	28 April 2006	8 May 2006	11 May 2006	11 May 2006
<b>Good</b>	Phones	Phones	Phones	Phones	Phones	Phones	CPUs	Phones	Phones
<b>Chain of suppl</b>	Macdelta	Macdelta	Macdelta	Macdelta	Macdelta	Macdelta		Macdelta	
	SS Enterprises ("SS")	SS	SS	SS	SS	SS		SSE	Macdelta
	Park	Daraj	Daraj	Park	Daraj	Daraj	Okeda	Park	SSE
	Performanc	EDS	Performan	EDS	Performan	EDS	Time	Performan	Phone

	e		ce		ce			ce	Shop
	High Speed	XSL	High Speed	High Speed	XSL	XSL	DDM	High Speed	Performance
	Fortwell	Vantage	Fortwell	Fortwell	Vantage	Vantage	Qiass	Cormilla	Tibuski
	Multisystems Technology ("MT")	MT	MT	MT	MT	MT	21st	MT	MT
<b>Sup</b>	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal
<b>App</b>	Gandalf IT	Gandalf IT	Gandalf IT	Gandalf IT	Gandalf IT	Gandalf IT	Gandalf IT	Gandalf IT	Gandalf IT
<b>Cust</b>	GSM	GSM	GSM	GSM	GSM	GSM	IT Swiss		

### Defaulting trader SS Enterprises

49. HMRC Higher Officer Gary Saul provided evidence regarding SS Enterprises, which was incorporated on 13 February 2006 and registered for VAT with effect from 3 April 2006. The VAT1 stated the Company's main business activity to be "trading in art, decorations, furniture, rugs of African & European style." The director, Mr Stephen Sarumi, was appointed on 13 February 2006 and the Company's principal place of business was 8D Block, Peabody Estate, Dalgarno Gardens, London.

50. Mr Saul carried out an unannounced visit to the principal place of business on 10 May 2006. It was a council flat on an estate. Mr Sarumi was interviewed and a Regulation 25 letter issued due to the volume of sales which had been carried out. The following day Mr Saul returned to the premises to uplift the records. The Company failed to make payment in relation to the output tax for the transactions carried out by the due date of 11 May 2006.

51. After reviewing the records Mr Saul noted that the sales invoices issued by the Company related to the acquisition of wholesale mobile telephones from the EC and onward sale within the UK and not the type of trading which had been declared on the VAT1. Mr Saul also established that SS Enterprises had acquired goods from the EC and made 101 sales of a total of 257,583 mobile phones worth in excess of £81 million in the 14-day period from 28 April 2006 to 11 May 2006. An assessment was issued to SS Enterprises on 9 June 2006 in the sum of £4,452,104.97 in respect of these deals. This was amended on or about 25 January 2008 to the sum of £14,240,764.54 due to an error.

52. On each sale SS Enterprises requested its customer to make 3<sup>rd</sup> party payments, which rendered it unable to meet its VAT liabilities on the relevant transactions. The assessment remains unpaid and was not appealed. The Company left its principal place of business and no forwarding address was provided to HMRC.

53. SS Enterprises was de-registered for VAT with effect from 11 May 2006 and placed into compulsory liquidation on 10 January 2007.

Defaulting traders Okeda and KEP

54. The remaining deal was traced to Okeda Ltd. An entity purporting to be Okeda  
5 had issued invoices using the VAT registration number of a de-registered company, Jool Ltd and deliberately defaulted on the VAT charged.

55. HMRC Officer Colin Needs provided unchallenged evidence regarding Okeda Ltd which was hijacked as part of an overall scheme to defraud the Revenue. Okeda came to the attention of HMRC on or about 21 February 2007 via Mr Jaskarn Jhaj  
10 who was the director of another a company called Time Corporates Ltd. As Okeda was never registered for VAT purposes there is no background information on the company.

56. On 2 May 2006 HMRC officer McMaster spoke to Mr Jhaj who stated that he was buying goods from a company called KEP 2004 and that third party payments  
15 had been made by his customer in all instances. It was established that Time Corporates dealt in mobile phones and computer chips. In May and June 2006 Mr Jhaj provided HMRC with some of the company's records. Mr Needs concluded in his witness statement that it appears likely from the records that Time Corporates purchased from only one supplier, KEP 2004, in the VAT period 06/06.

57. KEP was incorporated on 10 March 2004 and registered for VAT with effect  
20 from 1 October 2005. The VAT1 stated the trading activities were "supplying labour to the construction industry." An application to change the trade classification to "other business activities" was received by HMRC on 24 April 2004.

58. On 9 May 2006 HMRC made an unannounced visit to KEP. As no one was  
25 present at the principal place of business a letter was left advising that the company would be de-registered for VAT if it failed to contact HMRC. Contact was made with HMRC by the director, Mr Frederick Vasey, on 15 May 2006. He stated that KEP 2004 was wholesaling supplies of electrical goods including mobile phones, CPUs and computer software and that there had been 830 deals up to 2 May 2006 which  
30 totalled £291,000,000.

59. At a meeting with HMRC on 22 May 2006 Mr Vasey stated that he had not in fact completed any deals but had only raised purchase orders. He stated that he had received purchase orders from Time Corporates to the value of £291,000,000 but that  
35 no goods had been supplied or released. Mr Jhaj at Time Corporates subsequently told HMRC that he had been instructed by Mr Vasey to tell his customers to pay monies into bank accounts specified by Mr Vasey rather than directly to KEP.

60. HMRC set up a dummy registration for "trader purporting to be KEP 2004" on the basis of information received by HMRC officers from other traders. A number of assessments were raised against the dummy registration including two transactions  
40 which were traced to Sirrnet. KEP was deregistered on 9 May 2006 and dissolved on 14 April 2009.

61. On 30 May 2006 Time Corporates was de-registered and removed from the VAT register. On 21 February 2007 an undated letter was received by HMRC from Mr Jhaj which stated that purchases made by Time Corporates from 27<sup>th</sup> March to 8 May were from KEP 2004 Ltd and that from 9 May to 18 May purchases by Time Corporates were made from Okeda Ltd. Although the relevant year was not stated in the letter, as the company only traded in 2006 HMRC concluded that the omitted year should be 2006. On 22 March 2007 Mr Jhaj provided HMRC with a number of documents which related to Okeda including 145 invoices, a certificate of VAT registration and certificate of incorporation.

62. Investigations by HMRC into the VAT number contained on the invoices revealed that the VAT number had been issued to a trader called Jool Limited. The invoices showed a Companies House registration number which belonged to Okeda Limited. The director was said to be Mr Anjula Umesh Perera who was also the signatory of the VAT1 and related documents for Jool Limited which was removed from the VAT register on 16 June 2006 with effect from 15 December 2003 as it was deemed to be a missing trader. Jool Ltd had a debt of £10,614.93 written off due to the company being dissolved. It had also failed to submit any VAT returns and there had been no contact with HMRC since July 2003.

63. HMRC's attempts to contact Mr Perera by letter were unsuccessful. Consequently a pseudo VAT registration number was set up to establish Okeda's liability for VAT. An assessment was subsequently raised in the sum of £8,988,130.96 relating to the output tax recorded on the invoices received from Time Corporates for the period 8 May 2006 to 18 May 2006. The assessment included a transaction which involved Gandalf IT on 8 May 2006. Further assessments were subsequently raised which totalled in excess of £28,400,000.

64. Mr Needs concluded that an entity purporting to be Okeda Ltd used the VAT number of Jool Ltd. Mr Parera was a director of both companies whilst the company registered at Companies House as Okeda Ltd was never registered for VAT. Mr Parera has failed to respond to any of HMRC's attempts to contact him. He had also used a counterfeit VAT certificate which had not been issued by HMRC, which purported to relate to Okeda Ltd in an attempt to evidence that Okeda possessed a valid UK VAT number, which it did not. Okeda Ltd was a hijacked trader which was used as a vehicle to defraud the Revenue. The assessments raised remain outstanding and have not been appealed.

35 *Gandalf Asia*

65. In the 5 deals carried out by Gandalf Asia in June 2006 which all involved CPUs, the Appellant's immediate supplier was Syskal, which in turn was supplied by Multisystems Technology Ltd.

66. There was no dispute that the Appellant's deals 1 and 2 were traced back to defaulting trader Knightswood Ltd, which was the UK acquirer.

67. The relevant deals were as follows:

Deal No	Deal 1	Deal 2	Deal 3	Deal 4	Deal 5a	Deal 5b
Date	2 June 2006	6 June 2006	6 June 2006	12 June 2006	6 June 2006	6 June 2006
Goods	CPUs	CPUs	CPUs	CPUs	CPUs	CPUs
Chain					Premisten	
	Premisten	Premisten		Premisten	Knightswood	
	Knightswood	Knightswood		Knightswood	Fone Fingz	
	Fone Fingz	Fone Fingz	Fonedealers	Infinet	Sundial	Fonedealers
	Sundial	Sundial	Kingfisher	Sundial	Kingfisher	Kingfisher
	Emmen	Emmen	Fern	Emmen	Fern	Fern
	MT	MT	MT	MT	MT	MT
Sup	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal
App	Gandalf Asia	Gandalf Asia	Gandalf Asia	Gandalf Asia	Gandalf Asia	Gandalf Asia
Cust	Giga Asia	Giga Asia	Giga Asia	Giga Asia	Giga Asia	Giga Asia

### Knightswood

5 68. HMRC officer Mullarkey provided evidence regarding Knightswood which was incorporated on 17 March 2003 and registered for VAT with effect from 24 March 2003. The VAT1 signed by the director, Mr Sajid Mahmood, indicated that the company's intended business activity was "electrical and electronic goods – buying and selling."

10 69. Due to the goods in which the company intended to trade HMRC carried out a pre-registration visit on 17 April 2003. The company was based at 232 Argyle Street, Glasgow which was also the trading address of Future and Company UK (Europe) Ltd ("Future") where Mr Mahmood was employed and which was known to HMRC as a trader in MTIC type commodities. Mr Mahmood advised HMRC that he had severed ties with Future and was concentrating on phone repairs and accessories.  
15 Future was de-registered with effect from 2 May 2003 following a request by the director Mr Bashir.

20 70. Between August and November 2005 Knightswood had 6 suppliers. At a meeting with HMRC on 28 September 2005 Mr Mahmood confirmed that he had carried out several mobile phone wholesale transactions. The records relating to the transactions showed that Knightswood had received third party payment instructions from its suppliers which were passed to its customers. On 28 November 2005 Mr

Mahmood confirmed to HMRC that he had ceased trading in bulk supplies of mobile phones as he was concerned about third party payments.

5 71. On 7 December 2005 HMRC visited the company and found that Mr Mahmood had started dealing in bulk mobile phone supplies again. He told HMRC that he was using his own money to buy the phones, that he had a customer overseas and that there were no third party payments. HMRC had concerns that the trade had been manufactured to build up an input tax credit to offset against the VAT liability which had built up as a result of his UK to UK deals.

10 72. On 20 December 2005 Mr Mahmood told HMRC that he had not undertaken any more deals since 7 December 2005 and that he intended to sell repaired hi-fi units.

15 73. At a visit to the principal place of business on 15 June 2006 Mr Mahmood told HMRC that he had started dealing in mobile telephones approximately two weeks earlier and had completed about 30 deals. He stated that he bought from Spain and Estonia and sold in the UK. He stated that he only paid VAT on his commission. HMRC advised that as the company had acquired goods from another member state it was liable for output tax in respect of the full UK sale value.

20 74. Sales invoices uplifted showed that Mr Mahmood charged output tax to his customer however his bank account statements showed that he was only in receipt of small payments that would be insufficient to cover the VAT liability shown on the purchase invoices. Deal documents also showed payment instructions from Premisten based in the EU which were addressed to "all parties concerned" and which requested payments in excess of the amounts invoiced to Knightswood.

25 75. Regulation 25 letters were issued for the periods 1 March 2006 to 31 May 2006 and 1 June 2006 to 15 June 2006. The returns rendered showed VAT liabilities of £1,126.85 and £8,474,992.68 respectively.

30 76. Knightswood was de-registered for VAT with effect from 16 June 2006. On 30 January 2007 Knightswood was advised that its debt for periods 05/06 and 06/06 in the sum of £8,466,902.07 remained unpaid. The debt included VAT due on sales which were subsequently traced to purchases made by Sirnnet and Gandalf Asia. Knightswood has now been put into compulsory liquidation.

77. On 8 February 2007 Mr Mahmood wrote to HMRC to advise that all transactions had been cancelled in the presence of HMRC officers and no monies or goods had been exchanged.

35 78. On 23 November 2010 Mr Mahmood signed a formal undertaking which prohibited him from acting as a company director for a period of 15 years. The declaration accepted that between 2 June 2006 and 14 June 2006 he "knowingly caused Knightswood Ltd...to undertake a method of trade which involved it in, and put HMRC at risk of being subjected to, missing trader intra-community VAT fraud."

*Disputed deals of Gandalf Asia*



79. In respect of the remaining 3 deals (June 3, June 4 and June 5) it was noted on behalf of the Appellant in written closing submissions that in respect of Gandalf Asia's June deal 3 when it bought and sold 6,960 AMD Athlons the tax loss was assessed against Fonedealers.

5 Fonedealers

80. Evidence regarding Fonedealers was provided by HMRC officer Pearson. The company was registered for VAT with effect from 28 June 2004. Its intended business activity stated on the VAT1 was to buy and sell mobile phones. At a visit by HMRC on 24 March 2006 the sole director, Phillip Hon Yung Cheung, told HMRC that sales were made on the internet and ebay and the company had no involvement in wholesaling mobile phones.

81. It subsequently became known to HMRC that shortly after that visit Mr Cheung commenced wholesaling mobile phones and traded prolifically throughout April, May and early June 2006. All transactions involved purchases from and sales to UK traders and instructions to make third party payments were accepted.

82. At least 29 deals were carried out in the first two weeks of June 2006. The records provided to HMRC were incomplete in that in respect of 9 transactions no purchase invoice was provided by which Fonedealers' supplier could be identified, including two transactions it undertook with Kingfisher Traders Ltd which were traced to Gandalf Asia Ltd.

83. An assessment was issued to the company in the sum of £1,035,631.21 which included the two supplies which involved Gandalf Asia. Fonedealers was de-registered on 30 June 2007 and has been compulsorily wound up.

84. HMRC concluded that Fonedealers acted as a blocking trader in respect of the two deals involving Gandalf Asia on the basis that the company bought and sold goods within the UK but failed to declare or pay output tax and was unable to provide purchase invoices in respect of the transactions. In 20 deals for which purchase invoices were produced the named supplier's VAT registration details have been hijacked thereby concealing the supplier's identity.

85. Mr Holland submitted that HMRC has accepted that it cannot trace the chain beyond Fonedealers Ltd. Officer Leak gave oral evidence in which she told the Tribunal that HMRC withdrew an assessment against MG Components as it was allowed an input VAT disallowance on the basis that, on the balance of probabilities it was a buffer trader. Mr Holland contended that having accepted that Fonedealers was also a buffer trader HMRC raised an assessment against Fonedealers yet no satisfactory explanation has been provided regarding this difference in treatment.

86. HMRC set out in an addendum to its closing submissions the deal chain as traced by the documents available:

(a) on 6 June 2006 GiGa Asia issued a purchase order 10037 to Gandalf Asia in respect of 6960 x AMDs at a unit price of £127;

- (b) On 6 June 2006 Gandalf Asia issued an invoice 1144 to Giga Asia in respect of 6960 CPUs at a unit price of £127;
- (c) The CPUs supplied by Gandalf Asia to GiGa Asia had been purchased on 6 June 2006 from Syskal. On that date Gandalf Asia issued purchase order 141 to Syskal Distribution in respect of its purchase from Syskal of 6960 CPUs at a unit price of £123.50;
- (d) On 6 June 2006 Syskal issued invoice 101092 to Gandalf Asia in respect of 6960 CPUs at a unit price of £123.50;
- (e) The CPUs supplied by Syskal to Gandalf Asia had been purchased by Syskal from Multisystems Technology on 6 June 2006; Multisystems Technology issued invoice 518 to Syskal in respect of 6960 CPUs at a unit price of £122.50;
- (f) The CPUs supplied by Multisystems Technology to Syskal had been purchased on 6 June 2006 by Multisystemens from Fern Associates. On 6 June 2006 Multisystems Technology issued purchase order 519 to Fern Associates in respect of its purchase of 6960 AMDs at a unit price of £121.50;
- (g) On 6 June 2006 Fern Associates issued invoice number 6.6.06MULTITEC to Multisystems Technology in respect of 6960 AMDs at a unit price of £121.50;
- (h) The CPUs supplied by Fern Associates to Multisystems Technology had been purchased by Fern Associates on 6 June 2006 from Kingfisher Traders Ltd. On 6 June 2006 Fern Associates issued purchase order 6.6.06KING to Kingfisher Traders Ltd in respect of its purchase from Kingfisher of 6960 AMDs at a unit price of £121.20;
- (i) On 6 June 2006 Kingfisher Traders Ltd issued invoice 1260 to Fern Associates in respect of its sale to Fern Associates of 6960 AMDs at a unit price of £121.20;
- (j) The CPUs supplied by Kingfisher Traders Ltd to Fern Associates had been purchased by Kingfisher Traders Ltd on 6 June 2006 from Fonedalers Ltd. On 6 June 2006 Kingfisher issued purchase order 2030 to Fonedalers Ltd in respect of its purchase of 6960 AMDs at a unit price of £121;
- (k) On 6 June 2006 Fonedalers issued invoice 51013 to Kingfisher Traders Ltd in respect of its sale to Kingfisher of 6960 AMDs at a unit price of £121.

87. The tracing exercise by documents available was compared to evidence of HMRC officer Kenneway who traced payments made by the participants in the chain. The payments suggested that either Fonedalers was the acquiring trader or that, as a buffer trader, it had made third party payments which by-passed the acquiring trader.

88. HMRC noted that it was not put to Officer Pearson in cross-examination that Fonedalers should have been credited with an input VAT allowance and its

assessment withdrawn. Further it was submitted that the Appellant has confused the issues of tax loss and assessment; there is no requirement for HMRC to have raised an assessment against a trader in order to prove a tax loss. The assessment acts as an administrative device by which HMRC record the fact and quantum of unpaid tax as  
5 against a particular trader and require payment of that sum. The Tribunal need only be satisfied that in respect of each chain there is a demonstrable fraudulent tax loss.

89. HMRC also submitted that the Appellant has misunderstood its case in respect of Fonedealers. HMRC concluded that Fonedealers was a blocking trader whose actions prevented HMRC from tracing the identity of the acquiring party in its chains.  
10 Fonedealers. There is no requirement for HMRC to prove the identity of the importer of the goods. HMRC submitted that the following facts prove that there has been a fraudulent default in this particular chain:

(a) In 9 of Fonedealers 29 deals in June 2006 Fonedealers failed to produce purchase invoice documentation such as to block the further tracing of the chain;  
15

(b) In respect of those deals Fonedealers did not declare or account for output tax thereby creating a loss;

(c) In the 20 remaining deals the evidence suggests that the supplies to Fonedealers were made by a trader which had hijacked the VAT number of another trader;  
20

(d) On the evidence available it follows that Fonedealers purchased goods from a fraudulently defaulting trader or, alternatively failed to declare its sale of goods and account for output tax thereby creating a fraudulent tax loss.

90. The oral evidence of Officer Leak relied on by the Appellant related to MG Components Ltd, a trader not involved in this deal chain. HMRC argued that the oral evidence must not be viewed in isolation but by reference to the officer's written evidence which established that all of MG's deals which were declared to HMRC involved MG purchasing directly from a fraudulently acquiring trader. 68 deals in  
30 03/06 and 06/06 were not declared but on the balance of probabilities HMRC concluded that the purchases were made from a fraudulently acquiring trader. Assessments were issued in respect of the undeclared deals which were later withdrawn and replaced with an output tax assessment. In 12 of the 68 undeclared deals the identity of the defaulting trader has been established.

91. HMRC submitted that a comparison between the treatment of MG and Fonedealers is irrelevant to the issue of tax loss but is explicable by reference to information known regarding MG's deals and the lack of such information in respect of Fonedealers transactions.

92. In respect of Gandalf Asia's deal 5 on 9 June 2006 the Appellant submitted that  
40 HMRC have not established a chain of transactions. One HMRC officer, Ms Yeomans, concluded that only part of the deal could be definitely traced back to the defaulter Knightswood and the remainder was only traced as far as Fonedealers whilst

another officer, Ms Okoro thought it more likely than not that all of deal 5 could be traced back to Knightswood.

93. It was submitted that officer Yeomans acknowledged in cross examination that she could not trace the deal beyond Fonedalers. She had reached this conclusion by  
5 looking at the direct evidence such as purchase orders and invoices which did not establish a supply between Sundial and Fonedalers. Both Fonedalers and Knightswood have been assessed for the same unpaid VAT. The evidence was as follows (transcript day 2 page 21):

10 *“...Officer Okoro did the original chasing of the transaction chains.*

*Q. What role did you play? Did you just adopt her tracing exercise or did you look at it and think to yourself: "I'm not happy with that, I think we should do that"? What did you do?*

15 *A. I looked at every transaction chain myself and verified if it was correct.*

*Q. But Officer Okoro had traced it further and she traced it back to Knightswood?*

20 *A. On the balance of probabilities, Officer Okoro decided that it went back to Knightswood.*

*Q. On the same balance of probabilities you came to a different view, did you?*

25 *A. I didn't want to continue it on the balance of probabilities, I was happier to go with the evidence.*

*Q. There's a fair amount of discretion when looking at the balance of probabilities, is there? It's possible for two officers to reach a different decision?*

30 *A. I didn't look at the balance of probabilities, I looked at the direct evidence.*

*Q. Oh, right. She hadn't?*

*A. Officer Okoro had decided that in her opinion the balance of probabilities meant that the whole deal led back to Knightswood....*

35

*Q. ....there's no direct evidence of any supplies between Fonedalers and Sundial; is that correct?*

40 *A. I didn't have any evidence at the time to show that the deal had continued as Fonedalers, yes.*

94. HMRC submitted that the documentation available established the following:

- (a) On 9 June 2006 GiGa Asia raised purchase order 10038 in respect of its purchase from Gandalf Asia of 15,750 CPUs at a unit price of £78;

- (b) On the same date Gandalf Asia raised sales invoice 1145a in respect of its sale to GiGa Asia of 7,875 CPUs at a unit price of £78 and sales invoice 1145b in respect of its sale to GiGa Asia of 7,875 CPUs at a unit price of £78;
- 5 (c) The CPUs supplied by Gandalf Asia to GiGa Asia had been purchased by Gandalf Asia from Syskal. On 9 June 2006 Gandalf Asia issued purchase order 142 to Syskal in respect of its purchase of 15,750 CPUs at a unit price of £75.50;
- (d) On 9 June 2006 Syskal issued sales invoice 101093 to Gandalf Asia  
10 in respect of its sale of 15,750 CPUs at a unit price of £75.70;
- (e) The CPUs supplied by Syskal to Gandalf Asia were purchased from Multisystems Technology. On 9 June 2006 Syskal issued purchase order PO1905LR to Multisystems Technology in respect of the purchase of 15,750 CPUs at a unit price of £75;
- 15 (f) On 9 June 2006 Multisystems Technology issued invoice 519 to Syskal in respect of its sale of 15,750 CPUs at a unit price of £75;
- (g) The CPUs supplied to Syskal by Multisystems Technology had been purchased from Fern Associates. On 9 June 2006 Multisystems  
20 Technology issued purchase order 520 in respect of its purchase of 15,750 CPUs at a unit price of £74;
- (h) On 9 June 2006 Fern Associates invoiced Multisystems Technology on invoice 9.6.06MULTITEC in respect of its sale of 15,750 CPUs at a unit price of £73.70;
- 25 (i) On 9 June 2006 Fern Associates issued purchase order 9.6.06KING to Kingfisher Traders in respect of its purchase of 15,750 CPUs at a unit price of £73.70;
- (j) On 9 June 2006 Kingfisher invoiced Fern Associates on invoice 1265 in respect of its purchase of 15,750 CPUs at a unit price of £73.70. Those CPUs supplied by Kingfisher to Fern Associates came from  
30 Sundial and Fonedalers (half from each):
- (k) On 9 June 2006 Kingfisher issued purchase order 2035a to Fonedalers in respect of its purchase of 7,875 CPUs at a unit price of £73.45;
- 35 (l) On 9 June 2006 Fonedalers issued invoice 51020 to Kingfisher in respect of its sale of 7,875 CPUs at a unit price of £73.45;
- (m) The trader log for Kingfisher Traders shows that on 9 June 2006 on invoice 2099 Kingfisher Traders purchased 7,875 CPUs from Sundial at a unit price of £73.45;
- 40 (n) The trader log for Sundial shows that on 9 June 2006 Sundial purchased 7,875 CPUs at a unit price of £73.25 from Fone Fingz;

(o) The trader log for Knightswood shows that on 9 June 2006 Knightswood sold 15,750 CPUs to Fone Fingz on invoice 515 at a unit price of £73.25;

5 (p) The trader log for Knightswood shows that on 9 June 2006 Knightswood purchased 15,750 CPUs from Premisten on invoice 687-690 at a unit price of £73.15.

95. There is no sales or purchase documentation in respect of the sale of 7,875 CPUs from Fone Fingz to Foneddealers. Nevertheless HMRC submitted that the Tribunal can be satisfied that there was a fraudulent tax loss for the following reasons:

10 (a) Foneddealers was a blocking trader and the tax loss in respect of its purchase and sale of 7,850 CPUs may properly lie against it;

(b) The Tribunal can be satisfied that Fone Fingz supplied an additional 7,850 CPUs to Foneddealers on the basis of the evidence showing Foneddealers acquisition of the CPUs in the relevant quantity and on the  
15 relevant date.

(c) The deal chain matches the information set out in the diary containing deal chains which was seized in Operation Apparel (more about which we will say in due course); and

20 (d) FCIB payments showing Kingfisher making payments to Foneddealers and Sundial support the contention that the deal split at that point.

96. HMRC submitted that the evidence as to assessments being raised against Knightswood and Foneddealers is irrelevant to the test as to whether a fraudulent tax loss has been established.

25 97. The Appellant submitted that HMRC has not established a chain of transactions in respect of Gandalf Asia's deal 4 as it remains unclear on what basis HMRC has linked the transaction between Infinit Consultants and Sundial International Stock Traders Ltd ("Sundial"). No issue was taken with HMRC's tracing in respect of the remainder of the chain.

30 98. HMRC observed that no business records from VAT period 02/06 onwards were ever produced to HMRC by Sundial. At an insolvency meeting on 7 July 2006 the director Howard Symonds stated that all records and bank statements had been stolen from his vehicle on 2 July 2006.

35 99. HMRC therefore relied on evidence including deal logs contained on its Electronic Folder, FCIB payments and information from freight forwarders to prove the link between Sundial and Infinit as follows:

(a) HMRC's electronic folder shows that on 12 June 2006 sales invoice 20066072 was raised by Infinit to Sundial in respect of its sale of 15,750 CPUs at a unit price of £71.10;

(b) The same transaction listing on the electronic folder shows that Infnit purchased the same goods from Knightswood on purchase order 527 raised on 12 June 2006 at a unit price of £71;

5 (c) On 14 June 2006 the freight forwarder Point of Logistics was visited by HMRC. The manager told HMRC that the deal chain in respect of 15,750 CPUs received on 12 June 2006 was: Intertech; Premisten; Knightswood; Infnit; Sundial; Emmem; and Multisystems;

10 (d) The diary seized in Operation Apparel accurately reflected the quantity sold, date of transaction, freight forwarder and the selling prices between Premisten to Emmem;

(e) FCIB payments show payments from Emmem to Sundial and Emmem to Fonedalers. No payments were made to or from the Infnit FCIB account, or the Knightswood FCIB account after 15 March 2006.

*Sirnet*

15 100. HMRC Officer Gellvear was responsible for tracing the deal chains that involved Sirnet. There was no dispute that 18 of the 20 deals involving Sirnet were accurately traced back to defaulting traders. The defaulting traders involved were:

- KEP 2004 (April deals 1 and 2);
- Attic Attack Ltd (April deal 3);
- 20 • Anfell Traders Ltd (April deals 4 and 5);
- Skywide (April deal 6);
- Swindon Star (May deal 4);
- Causeway Initiatives Ltd (May deals 5, 6 and 7);
- SS Enterprises (May deals 1, 2, 3, 8 and 9);
- 25 • I Sales London Ltd (May deal 13);
- Tressle Ltd (May deals 10, 11 and 12)
- Fonedalers (June deal 1).

101. The relevant deals are set out below:

Deal	April 1	April 2	April 3a	April 3b	April 4	April 5	April 6	May 1	May 2
Date	7 April 2006	7 April 2006	5 April 2006	5 April 2006	24 April 2006	20 – 21 April 2006	12 April 2006	5 May 2006	5 May 2006
Goods	CPUs	CPUs	CPUs	CPUs	CPUs	CPUs	CPUs	Phones	Phines

<b>Supply Chain</b>								Maddelta	Maddelta
			Attic Attack				Skywide	SS	SS
	KEP	KEP	MG	Attic Attack	Anfell	Anfell	MG	Park	Park
	Time	Time	Optimal	MG	MG	MG	Optimal	EDS	EDS
	DDM	DDM	Emmen	Optimal	Optimal	Optimal	Fern	High Speed	XSL
	Qiass	Qiass	Yalegate	Tracker	Fern	Fern	Stardex	Cormila	Fortwell
	21st	21st	MI	MI	MI	MI	MI	MT	MT
<b>Supplier</b>	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal		
<b>App</b>	Sirnet	Sirnet	Sirnet	Sirnet	Sirnet	Sirnet	Sirnet	Sirnet	Sirnet
<b>Cust</b>	IT Swiss	IT Swiss	High Level	High Level	High Level	High Level	High Level	Freshnet	Freshnet

<b>Deal</b>	May 3	May 4	May 5	May 6	May 7 (1)	May 7 (2)
<b>Date</b>	5 May 2006	4 – 5 May 2006	4 – 5 May 2006	8 May 2006	5 May 2006	5 May 2006
<b>Goods</b>	iPods	CPUs	CPUs	CPUs	CPUs	CPUs
<b>Supply Chain</b>		PZP				
	Maddelta	Swindon				
	SS	MGC	Causeway	Causeway	Causeway	Causeway
	Park	Optimal	MGC	Realtech	Realtech	Realtech
	Performance	Emmen	Optimal	Optimal	Optimal	Optimal
	Tibuski	MI	Emmen	Emmen	Emmen	Emmen
	MT	Bytel	MI	MI	MI	MI
<b>Supplier</b>	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal
<b>App</b>	Sirnet	Sirnet	Sirnet	Sirnet	Sirnet	Sirnet
<b>Cust</b>	Freshnet	High Level	High Level	High Level	High Level	Berkshire

<b>Deal</b>	May 8	May 9	May 10	May 11	May 12	May 13	June 1
-------------	-------	-------	--------	--------	--------	--------	--------



<b>Date</b>	5 May 2006	5 May 2006	12 May 2006	12 May 2006	12 May 2006	17 May 2006	14 June 2006
<b>Goods</b>	Phones	Phones	Phones	Phones	Phones	Phones	CPUs
<b>Supply Chain</b>	Macdelta	Macdelta	Macdelta			Macdelta	Knightswood
	SS	SS	Tressle	Macdelta	Macdelta	Isales	Infnit
	Park	Park	Park	Tressle	Tressle	Phone shop	Sundial
	EDS	Performance	Performance	Phone shop	Park	Performance	Fonedalers
	High Speed	XSL	High Speed	Performance	Performance	XSL	Kingfisher
	Fortwell	Fortwell	Fortwell	Tibuski	Tibuski	Vantage	Fern
	MT	MT	MT	MT	MT	MT	MT
<b>Supplier</b>	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal	Syskal
<b>App</b>	Sirrnet	Sirrnet	Sirrnet	Sirrnet	Sirrnet	Sirrnet	Sirrnet
<b>Cust</b>	GTC	GTC	GTC	GTC	GTC	GTC	Giga Asia

102. The background to defaulting traders SS Enterprises and KEP 2004 has already been addressed in this decision and will not be repeated.

#### Attic Attack

5 103. HMRC officer Launder provided a witness statement regarding the trading activities of Attic Attack which is a fraudulently defaulting trader which supplied goods in one transaction chain which involved Sirrnet.

10 104. Attic Attack was incorporated on 5 September 2005 and registered for VAT with effect from 1 April 2006 (subsequently amended to 22 March 2006). The company's sole director was Mr Brian Cavanagh who resigned on 31 May 2007. The VAT1 declared the company's current and/or intended business activity as "loft conversions for storage."

105. Mr Cavanagh was also associated with the following companies:

- 15
- Rainbow Systems (Beeston) Ltd of which Mr Cavanagh was a director and against which a Winding up order was made on 3 October 2002 having failed to submit any VAT returns after 03/01 or pay central assessments and surcharges which resulted in a VAT loss of £18,569.92;
  - A&T Systems Ltd of which Mr Cavanagh was a director;

- A&T Systems Ltd (2) of which Mr Cavanagh was a director and in respect of which a Compulsory Winding up order was issued on 5 September 2006 with the company owing £3,389.55;
- Chedcrest Ltd of which Mr Cavanagh was a director and which went into voluntary liquidation on 24 January 2003 following an assessment and penalties totalling £36,149.00;
- CAV Electrical Ltd of which Mr Cavanagh was a director and against which a Compulsory Winding up order was issued with a debt of £60,002.60

106. HMRC visited the company on 8 May 2006 when they met Mr Cavanagh who explained that he was an electrician. He had incurred losses of £120,000 in a previous venture and was in need of additional funding in April 2006. He had discussed this matter with a local taxi driver, whose name he did not know, who had suggested that he trade in mobile phones. He had given the taxi driver a business card whereafter he received a lot of faxes from various sources. Mr Cavanagh said that he had panicked once he saw the values of the documentation sent to him and claimed to have sent letters to all contacts to advise them that Attic Attack would not be pursuing the deals.

107. Release notes in the name of Attic Attack which were in HMRC's possession were shown to Mr Cavanagh who denied producing the documents despite the signature on the documents appearing to be identical to that of Mr Cavanagh. Mr Cavanagh then stated that he may have signed the documents. He said he had received visits to his office by three individuals (who he believed were representatives of MG Components, Silverline and The Phone Shop) to whom he had given personal and business details such as the VAT registration certificate, bank details and trading licence. He produced a box containing documents which included invoices, payment instructions and purchase orders in respect of the sale and purchase of mobile phones. The VAT liability calculated following analysis of the documents was £3,122,078.12 which included two supplies which were traced to a single supply made by Sirnnet.

#### Anfell

108. HMRC Officer Davies provided an unchallenged witness statement in respect of the trading activities of defaulting trader Anfell which was incorporated on 5 June 2002 and registered for VAT as "Anfell College Limited" trading as a private tutorial college with effect from 1 April 2004. The VAT1 was signed by the director Anas Ahmed.

109. HMRC was notified by letter from Kamran Zubair & Co, a firm of accountants, that Anas Ahmed had been replaced on 6 February 2006 by Mr Abdul Khudus. HMRC was also informed that the company had changed its name from Anfell College Limited to Anfell Traders Limited and that the business activity would be general trading.

110. A visit was undertaken to the company by HMRC on 18 April 2006 in order to confirm the business activities. No one was present at the office and a letter sent from

HMRC's MTIC Team on the same date was returned as not known at the address. Consequently Mr Davies arranged for the VRN to be cancelled and the business trading as Anfell College Limited to be de-registered with immediate effect. The date of de-registration was subsequently amended to 1 May 2006. The registration was cancelled because Anfell College Limited had not made contact with HMRC and the revised activities of the business did not constitute a legitimate transfer of a going concern in accordance with the requirements of VATA 1994.

111. On 13 September 2006 Mr Davies visited the company and was told by the office manager that Mr Khudus had left the premises in early May 2006 owing rent. The trader had disappeared before HMRC could obtain any of the business records.

112. Anfell Trading Ltd was not VAT registered and should not have issued VAT invoices using the number allocated to Anfell College Limited. The director had been told not to do so on a number of occasions when he contacted HMRC. The business had knowingly issued invoices that were invalid. These invoices allowed companies to reclaim the input tax credits even though no output tax had been paid.

113. Anfell Trading Ltd failed to account for or pay HMRC tax due. Invoices issued to customers by the company have been assessed in the sum of £27,899,156 which remains outstanding. The assessment was not appealed and there has been no contact with Anfell since 8 May 2006.

114. On 1 March 2007 an assessment in the sum of £18,279,289 was raised against Anfell College Ltd which included two transactions traced to Sিন্নet which took place on 20 and 24 April 2006 and in respect of which Anfell College Ltd failed to account for output tax.

#### Skywide

115. HMRC Officer Yule provided evidence in respect of defaulting and missing trader Skywide which was incorporated on 5 August 1999 and registered for VAT with effect from 1 December 1999. The VAT1 signed by the director Mirchandani Ranjit Shersingh on 27 September 1999 described the main business activity as "Import and Export."

116. The company failed to file its annual accounts which were due on 30 June 2006 at Companies House. Between VAT periods 12/99 and 03/05 (inclusive) Skywide declared sales of £222,452. From 06/05 to its final VAT period no sales were declared by the company.

117. A Notice of Assessment for 06/05 sent to the Skywide on 12 August 2005 was returned by Royal Mail on 6 September 2005 as "Gone Away." On or before 19 April 2006 HMRC received documentation from Humber Freight which showed goods were released to Skywide from a Slovenian business, PZP ENA D.O.O. As a result of doubts as to the whereabouts of the company given the returned mail and concerns regarding goods often linked to MTIC fraud apparently being traded HMRC cancelled the company's VAT registration backdated with effect from 1 April 2005.

118. On 24 May 2007 a Notice of Assessment of Tax for undeclared output tax was raised against Skywide in the sum of £1,427,721 (later amended to £949,725.57). This assessment was raised as a result of paperwork supplied to HMRC by a UK based company called MG Components. The paperwork showed that MG Components had  
5 purchased goods from Skywide on 20 occasions between 11 and 18 April 2006. Included in the assessment was a transaction traced to Sirrnet which took place on 12 April 2006.

119. A further assessment was raised against Skywide in the sum of £660,675 on 27 November 2007 as a result of paperwork supplied to HMRC by a UK based company  
10 called Silverline UK Trading Ltd which demonstrated that it had purchased goods from Skywide Ltd on 21 occasions between 10 and 19 April 2006.

120. The assessments were neither paid nor appealed. Skywide's tax debt of £1,610,400 was written off by HMRC on 11 July 2008.

121. Information from Skywide's customers indicated that it required them to make  
15 third party payments to non-UK entities. Further indicia of the fraudulent nature of the company's transactions were that it traded goods worth £9,200,000 over just 10 days with no previous history in the market place, trading was carried out against a background of comparative dormancy, a change of address swiftly followed its trade in MTIC goods and the transactions were not declared.

20 Swindon Star

122. HMRC Officer Taylor provided a witness statement in respect of defaulting  
trader Swindon Star. The company was originally known as "Bestworld UK Ltd" ("Bestworld") which was incorporated on 7 November 2005. The company director was Lina Helvacioğlu and the company secretary was Firat Helvacioğlu. The business  
25 activities declared on the VAT1 submitted on 8 November 2005 were "catering, soft drinks."

123. On 11 January 2006 Firat Helvacioğlu notified HMRC of a change to the  
principal place of business and informed HMRC that the company had been sold to Mrs Fatmira Hoxha and that Companies House had been informed, although Mr  
30 Taylor noted that there is no evidence that Companies House was ever notified of a change in ownership.

124. By letter dated 25 January 2006 Lina Helvacioğlu notified HMRC that the  
company had changed from a catering company to the supply of soft drinks and alcohol.

125. On 8 March 2006 a handwritten letter which purported to be from the company  
35 outlined the change in name to Swindon Star. The letter also claimed that Lina Helvacioğlu and Firat Helvacioğlu knew nothing about Fatmira Hoxha. A VAT1 to register Swindon Star as a new entity was received by HMRC on 10 April 2006.

126. Allocation and release notes obtained from freight forwarder Point of Logistics  
40 on 3 and 4 May 2006 revealed that Swindon Star had acquired significant quantities

of CPUs and mobile phones from other member states, in particular PZP in Slovenia. Swindon Star in turn released the CPUs to MG Components and mobile phones to Realtech Distributions Ltd. This information caused HMRC to visit the company and when no one was present at the registered office an immediate de-registration letter was issued which advised that its VRN had been cancelled with effect from 4 May 2006.

127. On 22 June 2006 HMRC met Lina Helvacioğlu. She stated that a man named “Shak” or “Shahil” had come to her home in April 2006 “selling MTIC fraud” and advised her that Swindon Star could be paid 10p per unit to act as an agent in mobile phone deals. “Shahil” raised the invoices and sent her copies in the post. Ms Helvacioğlu provided a file of documentation to HMRC which showed that Swindon Star had supplied by companies in other member states and had passed payment instructions to its customers which requested that payment be split and made to third parties which meant that Swindon Star knew that it would have been unable to meet its VAT liability.

128. On 26 June 2006 an assessment in the sum of £16,864,792.72 was raised against Swindon Star. The assessment was based upon the records uplifted from the company which showed that goods had been purchased from PZP in Slovenia or Premisten in Estonia. On 20 July 2006 Swindon Star informed HMRC that the transactions in question had been cancelled; however the HMRC officer for MG Components confirmed that there was no evidence to support the assertion that Swindon Star had cancelled its supplies to MG Components.

129. Trading records for the period 26 – 28 April 2006 were examined. They showed that goods were purchased from Premisten in Estonia and PZP in Slovenia with Swindon Star as the acquirer. The EC suppliers had instructed third party payments to be made by Swindon Star’s customers with Swindon Star receiving insufficient sums with which to meet its VAT liability.

130. Purchase invoices from Premisten and PZP showed that they had been faxed to three different fax numbers, none of which matched that of Swindon Star which suggested that a third party was receiving the invoices on behalf of Swindon Star and posting them on. HMRC concluded that Ms Helvacioğlu was not involved in the day to day running of Swindon Star but had knowingly allowed the company to be operated by a third party. Swindon Star also attempted to reduce its tax liability by purporting to trade in telephone cards however it failed to produce any sales invoices for those goods.

131. HMRC concluded that Swindon Star had fraudulently defaulted in its VAT liability and assessments in the sum of £14,695,401 were raised against Swindon Star which included a sale by it to MG Components which was subsequently traced to Sirrnet.

132. On 26 November 2006 Swindon Star was wound up. The assessments have not been appealed or paid and there has been no further contact by Swindon Star with HMRC.

133. On 30 March 2009 Ms Lina Helvacioğlu was disqualified as a company director for a period of three years arising out of allegations by the Secretary of State that:

5 *“Ms Helvacioğlu, as sole director of Swindon Liquors caused goods, namely 20 pallets of beer being 19,200 litres to be condemned pursuant to Section 139(6) and Schedule 3 to the Customs and Excise Management Act 1979 by importing goods into the UK and causing Swindon Liquors to fail to pay the relevant duty of £42,542 on them.”*

#### Causeway Initiatives

10 134. HMRC officers Tilson and Fisher provided evidence regarding the fraudulent defaulter and missing trader Causeway Initiatives which was incorporated on 5 October 2005 and registered for VAT with effect from 1 April 2006. The VAT1 declared the company’s business activity as “advertising consultants.”

15 135. Companies House records show that there were no appointed company officers at the time the company applied for VAT registration. A document submitted to Companies House by Lloyd Hallowell on his appointment as director misspelt the company name as “Causeway Initives Ltd.”

136. On 23 March 2006 HMRC received a fax signed by Carl Beasley who identified himself as a director. He advised that the trading address of the company was also the residential address of “one of the directors.”

20 137. Correspondence sent by HMRC to the company at its registered address on 2 May 2006 was returned marked “not known at this address.”

138. Causeway was de-registered for VAT with effect from 10 May 2006 (subsequently amended to 31 May 2006).

25 139. At a visit by HMRC to ASR Logistics on 16 May 2006 allocation and release forms from Causeway were provided which showed a different address to that registered with HMRC. HMRC also subsequently located documents which appeared to relate to trading by the company in May 2006.

30 140. Causeway failed to render any VAT return or declaration of liability since its registration. For the period 12 September 2006 to 9 September 2008 assessments in excess of £22,000,000 have been raised against the company. Included in the assessments were two deals traced to Sirrnet. The assessments have not been paid or appealed and the company is deemed to be a missing trader.

#### Isales

35 141. HMRC Officer Cook provided evidence relating to the trading activities of Isales (London) Ltd which was incorporated on 21 December 2005 and registered for VAT with effect from 16 February 2006. Vital Anthony Gateley-Biebuyck was appointed sole director on 31 January 2006 and company secretary on 15 February 2006. On 4 May 2006 Lewis Alto was appointed as company secretary.

142. The VAT1 declared the business activity as that of a “wholesaler of household goods, medical equipment and electronic goods, e.g. fridges, ovens etc.” Further information was provided in writing by the company director at the request of the National Registration Unit stated that the main business activity was “purchasing and supplying household products and medical equipment.” HMRC noted that no trade is recorded as having taken place in the declared business activity and records uplifted by HMRC indicated that the company had traded exclusively in mobile phones and Apple ipods over a three day period during which it completed almost £78,000,000 worth of sales.

143. Isales acquired the goods from a Cypriot company called M@delta. Payment instructions issued by Isales in respect of 59 of its 60 transactions showed that it had requested customers to pay the bulk of the invoice amount to M@delta and (in 6 of the transactions) a small amount to Multimode Ltd. The sum left due to Isales was insufficient to enable it to discharge its VAT liabilities.

144. Isales was de-registered for VAT with effect from 22 May 2006. An assessment was raised against the company in the sum of £11,589,040 on 25 May 2006 which included a transaction which was traced to Sirrnet. The assessment has not been paid and was not appealed.

145. On 15 May 2008 Mr Gateley-Biebuych signed a formal undertaking which prohibited him from acting as a company director for a period of 12 years. In signing the declaration he accepted that between 17 and 19 May 2006 he “knowingly caused Isales London Ltd...to undertake a method of trade which involved it in, and put HMRC at risk of being subjected to, missing trader intra-community VAT fraud.”

Tressle

146. HMRC Officer Okoro provided information regarding the defaulting trader Tressle Ltd which was incorporated on 6 June 2005 and registered for VAT on 9 August 2005. The VAT1 declared the intended business activities as trading in power tools and accessories for the home and garden. The director was Ali Aziz and the company secretary was Tasia Baksh. Only two VAT returns have been filed by the company; the first was a nil return.

147. At a visit by HMRC to the company on 16 May 2006 Mr Aziz informed the officers that he had started dealing in mobile phones the previous week and had conducted 62 deals although he had yet to receive payment. He stated he received payment instructions from his suppliers. Records uplifted from the company demonstrated that Tressle had acquired phones from a Cypriot supplier and instructed UK customers to make payment as requested by the supplier.

148. Tressle failed to render its return for 05/06. Within 2 weeks of trading from 1 – 16 May 2006 Mr Aziz ran up a debt in excess of £9,000,000 from trading in mobile phones. The paperwork uplifted by HMRC showed payment instructions from Tressle which make clear that Tressle was only intended to receive part of the monies due on the sales invoices and that a high proportion went to his supplier’s bank account.

149. On 5 June 2006 an assessment was raised against Tressle in the sum of £9,915,425.66, which includes three transactions in which Tressle was supplied by M@cdelta and which were traced to Sirnnet. Two further assessments were subsequently raised; the amount which remains outstanding is £13,179,901.

5 150. On 25 March 2008 Mr Aziz signed a formal undertaking which prohibited him from acting as a company director for a period of 11 years. Mr Aziz accepted that between 11 and 16 May 2006 he “knowingly caused Tressle Ltd...to trade in a manner which involved it in, and put HMRC at risk of being subject to, missing trader intra-community fraud.”

10 *Sirnnet’s Disputed Deals*

15 151. Mr Holland submitted that Sirnnet’s June deal 1 had not been traced by HMRC due to the lack of evidence showing the link between Fonedealers and Sundial. HMRC Officer Cummins stated in oral evidence that she believed she had traced the deal between the two by using the Electronic Folder rather than the records found in the diaries seized in Operation Apparel. That being so the diaries cannot be relied upon by HMRC to show the link and, as far as the Appellant understands, the information used by the officer was prepared by a trader who “*presumably the Respondents regard as being fraudulent.*”

20 152. HMRC submitted that the tracing of this particular chain has progressed since the decision to deny Sirnnet its right to input tax repayment. Initially Ms Gellvear had been unable to trace the chain beyond Fonedealers and input tax was disallowed on the balance of probabilities. Subsequently the acquiring trader was identified as Knightswood and the relevant part of the chain was traced as follows:

- 25 • On 14 June 2006 Kingfisher raised an invoice against Fern in respect of its sale to Fern of 23,625 CPUs at £69.70 per unit;
- On 14 June 2006 Kingfisher issued purchase order 2038 to Fonedealers in respect of its purchase from Fonedealers of 23,625 CPUs at £69.50 per unit;
- On 14 June 2006 Fonedealers raised invoice 51019 against Kingfisher in respect of its sale of 23,625 CPUs at £69.50;
- 30 • The deal log obtained from HMRC’s Electronic Folder in respect of Infnit showed that Infnit sold 23,625 CPUs on sales invoice 20066083 to Sundial;
- The Electronic Folder also showed that Infnit purchased 23,625 CPUs at £69.30 on purchase invoice 538 dated 14 June 2006 from Knightswood;
- 35 • Purchase invoice 20063083 was issued by Infnit to Knightswood on 13 June 2006 in respect of its purchase of 23,625 CPUs at £69.30 per unit;
- HMRC’s Electronic Folder for Knightswood showed that it sold 23,625 CPUs on sales invoice 538 dated 14 June 2006 to Infnit at £69.30 per unit;



- The deal log in respect of Knightswood shows that on invoice 717-719 dated 14 June 2006 it purchased 23,625 CPUs from Premisten at £69.20 per unit.

153. HMRC explained that Sundial's director at an insolvency meeting on 7 July 2006 had stated that all business records and bank statements covering the relevant  
5 period had been stolen from his vehicle on 2 July 2006. Fonedalers had also failed to supply their purchase invoice in relation to this deal. As a result HMRC relied on the information available on its Electronic Folder which matched in terms of quantity of goods traded and date of trade. This information, which matched the relevant chain of transaction in the Operation Apparel diary in date, nature of goods and quantity traded  
10 established the link.

154. Regarding the disputed May 5 deal, Mr Holland submitted that the deal chain had not been sufficiently established by Ms Cummins on the basis that she acknowledged in her statement that the diary entry relied upon could read either  
15 "EW" or "CW" and that the wrong test was applied by the officer in concluding that CW is more likely to be (rather than more probable than not) Causeway. The diary entry is inconclusive and when taken together with the evidence of HMRC officer Leak that the chain could not be traced beyond MG Components, HMRC's evidence does not establish a fraudulent tax loss.

155. HMRC acknowledged that the chain of supply could not be traced using  
20 documents supplied to it by traders or freight forwarders. Instead HMRC relied on the diaries seized in Operation Apparel which contained a deal chain for "Thur 4/May" and in which "SIR" (Sirrnet) appeared. The diary matched the date and type of goods traded as traced by HMRC and recorded "CW" as the trader which sold to MG Components. Following her analysis of the diaries, Ms Cummins concluded that  
25 "CW" was Causeway.

156. In addition, HMRC relied on the evidence of HMRC officer Leak who confirmed that MG Components acted as a first line buffer and as such all of its purchases in 03/06 and 06/06 were from defaulting, missing or hijacked traders. Furthermore HMRC have identified 68 deals in which MG Components itself did not  
30 declare a number of deals to HMRC. HMRC invited the Tribunal to infer that MG Components in this deal continued to purchase from defaulting, missing or hijacked traders and that the diary entry provides additional support for that inference.

**Findings on whether the tax loss was fraudulent and whether the Appellants' transactions connected with fraudulent VAT losses?**

35 157. We will address the deals that were specifically challenged before setting out general observations and findings in respect of whether tax losses were established by HMRC, whether those losses were fraudulent and whether the Appellants' transactions were connected to those losses.

GA June deal 3

158. We carefully considered the Appellants' submissions. However we were satisfied that the issue of which trader was assessed is not relevant to issue we have to determine in this appeal, namely whether we are satisfied to the requisite standard that there was a fraudulent tax loss in the Appellants' chain of supply.

5 159. We accepted the evidence of HMRC that Fonedalers deliberately acted as a blocking trader and that its actions in doing so were designed to prevent HMRC tracing the identity of the acquiring party.

160. The test which we must apply does not require HMRC to prove who the acquiring party was but rather whether a tax loss has been established.

10 161. We were satisfied that there was such a tax loss caused by Fonedalers' failure to declare or account for output tax in 9 of its deals in June 2006. We were also satisfied that this failure on the part of the trader formed part of an overall scheme to defraud the revenue.

15 162. We accepted that in the remaining 20 deals in June 2006 Fonedalers purchased from a trader with a hijacked VAT registration number. In those circumstances we were satisfied on the balance of probabilities that the goods had been purchased from a fraudulently defaulting trader.

#### GA June deal 4

20 163. The argument from the Appellant arose as a result of the lack of business records which to demonstrate a link between Infnit and Sundial.

25 164. We were satisfied that the evidence relied on by HMRC, namely information contained on the Electronic Folder when taken together with information received from the freight forwarder Point of Logistics established the link between the traders. We also noted that the chains of supply recorded in the diaries seized as part of Operation Apparel (which are set out in more detail later in this decision) matched in terms of quantity of goods sold, date of the transaction, freight forwarder used and selling prices. The chain set out in the relevant diary extract in respect of this detail confirmed a sale between Sundial and Infnit which strengthened our conclusion that the deal chain had been accurately established by HMC.

#### GA deal 5

35 165. The issue in this transaction chain arose due to the fact that the deal was split until a purchase was made by Kingfisher. HMRC officers Yeomans and Okoro agreed that the deal could be traced to Sundial and Fonedalers from whom Kingfisher purchased the goods but Ms Yeomans limited her evidence to what could be directly evidenced whereas Ms Okoro concluded that, on the balance of probabilities, the entire deal would trace back to Knightswood.

166. For the reasons already set out at paragraphs 159 to 162 we were satisfied that a fraudulent tax loss had been established by HMRC in respect of this deal. We noted that the documents relied on by HMRC, including invoices and trader logs, indicated

5 that the deal had been split between Knightswood and Kingfisher. We also noted that the relevant diary extract from Operation Apparel matched the chain as submitted by HMRC. In those circumstances we were satisfied on the balance of probabilities that taking all of the evidence together, both direct and indirect, a fraudulent tax loss had been established.

#### Sirnet June 1 deal

10 167. We were satisfied that the information available on HMRC's Electronic Folder which matched in terms of quantity of goods traded and date of trade established the chain to the requisite standard. We also noted that the tracing using the Electronic Folder matched the relevant chain of transactions in the Operation Apparel diary in date, nature of goods and quantity traded. In those circumstances we were satisfied that the disputed link, and therefore a fraudulent tax loss, had been established.

#### Sirnet May 5 deal

15 168. We were satisfied that the conclusion of Ms Cummins following her review of the diaries was not undermined in cross-examination. We were also satisfied that the manner in which MG Components traded, namely as a first line buffer which, in the relevant period, purchased from defaulting, missing or hijacked traders supported the compelling inference that it had been supplied by Causeway Initiatives. In those circumstances we were satisfied that on the balance of probabilities HMRC had accurately traced the deal chain to a fraudulent tax loss.

#### Observations and Findings of Fact

169. We found the evidence in respect of the defaulting and blocking traders was cogent and compelling. In light of that finding we were satisfied that the Appellants' chains of supply had been accurately traced back to tax losses.

25 170. We were also satisfied that the tax losses resulted from the fraudulent evasion of VAT either as a result of the actions of the defaulting traders or where a trader had acted as a blocker in order to deliberately prevent HMRC from tracing the relevant supply chain. In the latter case we had the benefit of FCIB evidence and diary entries seized in Operation Apparel which led to the overwhelming inference that on the balance of probabilities those deals also traced back to a fraudulent tax loss.

30 171. Without pre-judging issue of the Appellant's knowledge, we were satisfied that the transactions were contrived and part of an overall scheme to defraud the revenue. We agreed with HMRC that the issue as to which trader had been assessed was irrelevant to the test to be applied; namely whether there was a tax loss and whether that tax loss was fraudulent.

35 172. The Chancellor in *Blue Sphere* set out the necessary connection with fraud. On the facts we have found we were wholly satisfied that the Appellants' transactions were so connected.

**Did the Appellants know, or should they have known that the transactions in this appeal were connected to fraud?**

173. HMRC must satisfy us that the Appellants either knew or, in the alternative, should have known that their transactions were connected to fraud.

- 5 174. The majority of evidence heard related to this issue. Given the volume of evidence before us, both oral and documentary, the following is intended as a summary of the points raised; however we should make clear that all of the evidence was carefully considered.

*Evidence of HMRC*

10 Awareness of MTIC fraud, links to other companies and funding

175. HMRC argued that the company officers of the Appellants had a good awareness of MTIC fraud via the company's business activities and links to other companies which traded in the same industry in a similar manner.

- 15 176. In addition to being professionally represented by reputable accountancy firms since 2005, who HMRC assumed would have advised their clients of the risks of MTIC fraud, HMRC also notified the Appellant that the industry was rife with fraud on a number of occasions for example by issuing VAT Notice 726 at a visit to Sirrnet on 19 November 2004. Ms Yeomans inferred that a due diligence check document produced by KPMG for Syskal at a cost of £10,000 was likely to have been shared  
20 with Gandalf Asia and Gandalf IT after the shareholders of Syskal took over.

177. HMRC Officer D'Rozario gave evidence regarding Syskal's awareness of fraud via Mr Rowlands. He confirmed that he had been told by a colleague that Syskal undertook all necessary due diligence checks. He also exhibited a VAT audit report relating to a visit to Syskal on 7 January 2005. At the foot of the report Mr D'Rozario  
25 had added under the heading 10/01/05:

- 30 *"Discussed business activities with Llion Rowland (Dir.) He said that he has been discussing the future activities of the company with Alan Gould, and feels that they may pull out of the export market. He said they have significant concerns about getting their refunds back quickly on any future claims they may submit, particularly that they have been verbally informed by HM C & E that all the deals within period 09-04 begin with a defaulting/missing trader.*

*Mr Rowland went on to say that for moral reasons they may get out of this trade (back to back bulk deals) – that VAT is going unpaid in the UK and that they are in some way unwittingly playing a part in this..."*

- 35 178. Mr D'Rozario confirmed in re-examination (transcript day 3 page 25):

*"...whatever interaction I had, whether it was on the telephone or at a visit, I would have recorded it either -- if it was at the principal place of business, their*

*premises, it would be in my notebook and then transferred to a visit report or if I rang him or he rang me I would put it in the case progress log.*

5 *Q. I see. Whichever method was used, would you have done your best to make this as accurate a record of the conversation as you could?*

*A. Yes."*

10 179. In oral evidence regarding due diligence HMRC Officer D'Rozario stated (transcript day 3 page 12):

15 *Q. If we go over the page, 12/24, and if you look at the last two paragraphs, here you are recording a telephone call I think which you had with Llion Rowlands, the director of Syskal, and I will read it out to you: "He stated that they employ KPMG, who carry out all necessary due diligence checks on their immediate suppliers. They do not conduct full deal line checks as this would cost the company too much, Mr Rowlands said. He went on to say that he cannot be held accountable for those traders sitting in a chain of supply that fall prior to his immediate supplier. I agreed but I replied that I believe that a full verification is necessary." Yes?*

20 *A. Yes.*

*Q. So when you say you agreed, what do you mean by that..you agreed with Mr Rowlands' statement that he couldn't be held accountable for those traders sitting in the chain of supply that fell prior to his immediate supplier?*

25 *A. Because as a trader he would only be accountable for his, as it were, co-contractor for the due diligence on his immediate supplier and his immediate customer.*

*Q. Yes. He couldn't do due diligence on anybody else in the supply chain, could he?*

*A. Not as a director, but they can, as they did, employ KPMG or an accountant who would do a third party check on their behalf.*

30 *Q. On their immediate suppliers and immediate customers?*

*A. No, on the subsequent beyond those immediate suppliers because they were doing -- KPMG was telling us that they were going to do a line check on the transaction chains beyond Syskal's immediate supplier.*

35 *Q. Well, that was after -- if they were able to find out who had sold goods to their immediate supplier and immediate customer?*

*A. Well, that's right, but that's quite easy to do. All they do is go to Syskal's immediate supplier and ask -- tell them that they're working on behalf of Syskal and*

that they had a confidentiality arrangement going through, just set out that they wouldn't disclose that information to Syskal.

5 Q. If you go over the page, I2/25, four paragraphs down, this is a telephone call that you had with Kim Hutchens from KPMG on 2 November 2004: "She went on to state that Syskal undertake all necessary due diligence checks and cannot be more helpful to our department. I replied that I accept what she is saying." So you accepted that Syskal undertook took all necessary due diligence checks? Can we infer that from what you say?

10 A. I think what I was meaning there was, because I hadn't actually seen any due diligence at this time, I was saying it from what they've told me verbally and what Kim Hutchens had been telling me over the phone."

15 180. HMRC relied on the association between the Appellants and Mr Dawson who was the director of Multi Systems International ("MI"), Multi Systems Global ("MG") and Sole Proprietor of Richard Dawson trading as Multi Systems Technology ("MT"), all of which had received several warnings about MTIC fraud. No details were provided to HMRC regarding the transfer of ownership of Gandalf Asia and Gandalf IT in April 2005 despite HMRC requesting by letter dated 30 November 2007 to Mr Dawson information pertaining to the value of the sale and any financial interest retained. HMRC noted that despite Mr Rowlands' assertion that following the transfer 20 Mr Dawson was no longer involved with Gandalf Asia or Gandalf IT, the companies continued to trade from the same premises as MT, MG and MI and all conducted similar trades. Ms Evans who took over as director of Gandalf Asia and Gandalf IT had been Mr Dawson's office manager since 2004.

25 181. Ms Gellvear on behalf of HMRC highlighted the links between the shareholders of the Appellants. By way of example Mr Gould and Mr Rowlands were both shareholders in all 3 of the Appellant companies and had also held roles as company officials in Syskal.

### Syskal

30 182. Syskal was registered for VAT with effect from 1 October 2002. The business activity of Syskal stated on the VAT1 was IT and Telecommunications Retailer and Provider. It also had two associated companies; Gen X IT Ltd and Syskal International Ltd, which changed its name to Bytel Distribution Ltd ("Bytel"). On 31 August 2005 Syskal International Ltd was sold for £5,000. At a visit by HMRC in September 2005 it was noted that the company was trading in CPUs and that its only 35 customers between September 2005 and February 2006 were Syskal and another associated company, Manatlantic. Syskal financed its deals with loans from Crestvalley Trading Ltd ("Crestvalley"), the director of which was said to be a friend of Mr Rowlands.

40 183. Ms Gellvear outlined the contact between HMRC and Syskal in which the presence of fraud in the industry was communicated, most notably at a visit to Syskal on 7 October 2003 at which HMRC officer Mody recorded that Mr Rowlands was

“very familiar with the legislation” (referring to Joint and Several Liability provisions and the Notice of Requirement to provide Security). Syskal had also been notified by letter dated 14 March 2004 that all 9 of its export deals in September 2004 had been traced to a tax loss. HMRC noted that notwithstanding this information Syskal continued to trade with the immediate suppliers in whose chains tax losses had been identified.

184. In respect of SIRRNET Ms Gellvear formed the view that the sole intention of the first deal declared by the company was to obtain VAT registration. Although the company’s VAT 1 made no reference to undertaking wholesale deals of computer chips Ms Gellvear concluded that this was always the intention of the company and its declared business activity was designed to circumvent the checks applied by HMRC to any VAT application which identified computer chips as the trading activity. Ms Gellvear noted that as SIRRNET’s customer’s purchase order was in US dollars rather than sterling the company made a loss of £2,000.

#### 15 Pickering Financial Services

185. Pickering Financial Services (“PFS”) was incorporated with effect from 13 August 2004 and registered for VAT with effect from 1 September 2004. It used a letter from Syskal (with which it shared an address) dated 23 August 2004 as evidence of intent to trade in “accountancy and management services.” The letter stated that Syskal would use PFS “for the preparation of management accounts, advice on due diligence and handling investor relationships.” Mr Gould was appointed as company secretary on 13 August 2004 and resigned on 16 August 2004. Mr Pickering was appointed as director on 13 August 2004 (to date). Mr Rowlands and Mr Gould held a 95% shareholding with Mr Pickering holding the remaining 5%.

186. In 2005 Mr Pickering was interviewed about the source of a loan that PFS had supplied to SIRRNET which had come to light via a fax from SIRRNET to HMRC dated 5 April 2005 and which had not been declared by PFS on its VAT 1. It was noted by HMRC that Syskal’s annual accounts for the year ended 31 March 2005 showed that it had provided a loan facility of £1,780,700 to PFS, although this was denied by Mr Pickering in a telephone conversation with HMRC on 13 July 2005. An email was received by HMRC from Mr Ryder dated 21 April 2006 in which he stated that PFS funded SIRRNET’s VAT expenses for each deal As PFS had provided a debenture to SIRRNET for the sum of £750,000 (about which SIRRNET has failed to provide any information) HMRC submitted that it could be concluded that SIRRNET was funded indirectly by its supplier Syskal.

187. Ms Yeomans noted that PFS appeared to act as guarantor for loans made by Highwater Properties Ltd to Gandalf Asia, Gandalf IT and Syskal.

#### The Multisystems Companies

188. The intended business activity declared on the VAT 1 of MSI, signed by Mr Dawson on 25 July 2002, was “IT hardware” and the company was registered for VAT with effect from 25 July 2002. On 1 May 2003 Mr Dawson was notified by

HMRC about the on-going problems in the mobile phone trade sector. Mr Dawson's subsequent verification of VAT numbers via HMRC's Redhill office indicated an understanding of the need to check trading counterparties. Correspondence was also sent to MI from HMRC in April 2005 in which the problems of MTIC fraud were outlined. It was HMRC's case that despite the fact that MI, through Mr Dawson, must have been aware of fraud within the trade sector, it nevertheless traded prolifically as a buffer. The company was also denied input tax amounting to £18,122.34 as HMRC considered that the one relevant transaction was part of an overall scheme to defraud the public revenue; a decision which was not appealed by MI. The supplier in the deal in question was also present in one of SIRRNET's deal chains in April 2006 and HMRC noted that 4 other companies which supplied MI in its April and June 2006 quarters also appear in SIRRNET's transaction chains. MI was de-registered from 20 December 2007 on the basis that the indication that it would continue to trade from the director's home address after its business premises were vacated has never been supported by evidence.

189. MT was incorporated on 30 June 2005 and registered for VAT on 1 July 2005. The business activity was stated to be the export of computer hardware. Mr Dawson held a 50% shareholding with the remaining 50% held by Mr Darren Bagnall who was convicted on 6 February 2007 of money laundering offences at Manchester Crown Court following Operation Holdback in which documents containing transaction chains associated with MTIC deals were found in Mr Bagnall's hotel room at the time of his arrest. The deal chains contained in the documents included MI which was a buffer trader in 8 SIRRNET deals and MT which was a buffer trader in 10 SIRRNET deals, 7 Gandalf IT deals and 5 Gandalf Asia deals.

190. MG was incorporated with effect from 13 October 2004. The VAT 1 signed by Mr Dawson on 18 February 2004 declared the intended business activity as "export of computer hardware." MG also received correspondence from HMRC regarding MTIC fraud in letters dated 28 February 2005 and 7 June 2005. MG was de-registered from VAT with effect from 3 December 2008 as it had been struck off at Companies House on the same date. On 2 July 2007 MG was notified by HMRC that its input tax claim for periods 04/06 and 05/06 in the sums of £68,907.37 and £200,880.75 respectively had been denied. The appeal against the decisions was subsequently withdrawn.

191. HMRC highlighted the fact that one of MG's deal chains in April 2006 and one in May 2006 mirrored to a large degree that of SIRRNET in April 2006 (deals 4 and 5) and May 2006 (deal 4) as follows:

April:

	<b>Acquirer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Broker</b>
<b>MG</b>	Anfell	Swindon Star	MG Components	Optimal Group	Fern Assocs	MI		MG
<b>SIRRNET</b>	Anfell		MG Components	Optimal Group	Fern Assocs	MI	Syskal	SIRRNET



May:

	<b>Acquirer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Buffer</b>	<b>Broker</b>
<b>MG</b>	Swindon Star	MG Components	Optimal Group	Fern Assocs	MI		MG
<b>Sirynet</b>	Swindon Star	MG Components	Optimal Group	Emmen	Bytel	Syskal	Sirynet

5 192. Ms Gellvear's witness statement documented the correspondence from HMRC to Gandalf Asia and Gandalf IT which informed the companies about MTIC fraud in its trade sector. Letters were sent on 2 February and 28 February 2005 (to Gandalf Asia); the latter was also addressed to Gandalf IT, MG and MI due to their associations via company officials. Gandalf IT received similar correspondence on 10 February 2004, 22 November 2004 and 28 February 2005.

10 193. Ms Gellvear noted that Gandalf Asia and Gandalf IT were both notified by letter dated 24 May 2005 that tax losses had been found in the supply chain of Gandalf IT in periods 10/04 and 03/05 and in which Gandalf IT's sole supplier had been Syskal. Nevertheless both companies continued to trade with Syskal. Gandalf Asia was also notified by letter dated 7 June 2005 that third party payments had been made by  
15 traders in its supply chain.

194. HMRC issued correspondence regarding MTIC fraud to Manatlantic on 3 May 2005, 25 May 2005 and 24 June 2005. The director Mr Rogelj emailed HMRC on 28 June 2005 acknowledging the concerns notified by HMRC regarding fraud in the industry. On 7 November 2005 HMRC notified Manatlantic that 4 deals in June and  
20 August 2005 had commenced with a defaulting trader; the supplier to Manatlantic in 3 of the deals was MI. HMRC also noted that Syskal had purchased goods from MI which were then supplied to Sirynet in 4 deals in April 2006. Manatlantic's repayment claims for 03/06 and 06/06 were subsequently denied following extended verification.

25 195. HMRC officer Harris provided an overview of the links between the various companies referred to above, the source of the Appellants' funds and how they were connected to the providers of those funds. She noted that Mr Rowlands' witness statements referred to "joint ownership" of the Appellant companies which he considered to be part of a larger group of companies. Mr Rowlands explained, referring to Sirynet, that there was a "*group structure of companies that the company*  
30 *(i.e. Sirynet) would always purchase its stock from Syskal.*"

196. Ms Harris reviewed a loan agreement letter from Highwater Properties Ltd dated 22 February 2005 which indicated that loans were to be made to the companies listed in a schedule attached to the letter; those companies were defines as "*the associated*

*companies” and “relevant companies means your company and the associated companies.”*

197. By connections through directorships and shareholding Ms Harris treated the following as connected companies:

- 5           •Gandalf Asia
- Gandalf IT
- Sirnnet
- Syskal
- Syskal International
- 10          •MG
- MT
- MI
- Express IT
- Manatlantic

15    Funding

198. Funding for the trading companies came from Crestvalley and Highwater Properties Ltd (“Highwater”). The directors of Highwater were Abraham Van Praagh (from whom we heard evidence), Henrietta Van Praagh and Abraham Adler. Crestvalley loaned approximately £500,000 to Gandalf IT via Syskal before  
20    Highwater subsequently, in February 2005, loaned £2,000,000 via PFS to the group of companies; Ms Harris noted that one of the stated purposes of the loan from Highwater was that “*existing sums due to Crestvalley*” should be repaid. Highwater, a property management and rental company, borrowed funds from the bank using properties as security in order to make the loan. It secured its loan with debentures  
25    over the assets and undertakings of the group of “Associated Companies” and with a cross guarantee arrangement. Ms Harris noted on reviewing the document provided which purported to show the loan that nowhere in the document was the amount of the loan specified and the debenture over PFS’ assets as security provided little protection as the company had few assets.

30    199. Crestvalley was a private listed company whose trading activities concerned the wholesaling of bags. It was said by Mr Pickering (in a letter to HMRC dated 10 December 2004) that the loan it made to Syskal arose from an “*established relationship*” between Mr Dawson and Mr Rowlands.

200. Mr Rowlands' explanation of why there were a number of separately VAT registered companies, which was set out in his witness statement, was not accepted by HMRC. He stated that "*our business model was to set up our companies to take advantage of...ring fencing*" in order to effectively reduce the risk of the owners' assets being "*effected by one disaster*". Ms Harris noted that all of the companies relied on each other for trading purposes and the loan provided to them for working capital purposes was cross-guaranteed against each others' assets, and concluded that this meant that the liabilities were not ring-fenced. Ms Harris also queried who was in overall charge and who decided the group should be set up in such a way as Mr Rowlands' statement is unclear on the point, simply stating that: "*it was decided that each company should have a separate director.*"

201. An Investment Schedule of loans made by PFS to Gandalf Asia during 2005 and 2006 was reviewed by Ms Harris who noted that from 4 February 2005 to 28 June 2006 a total of £2,830,651.79 was loaned to the company. £2,094,927.06 was repaid with an outstanding balance of £735,724.73 as at 21 August 2006.

202. PFS also made loans to Gandalf IT; in the accounts for the Year Ended 31 January 2006 Gandalf IT stated that there was a "*loan balance amounting to £1,110,642...owed to Pickering Financial Services Limited...*"

203. PFS also made loans to SIRRnet, which was confirmed by Mr Ryder in a fax letter to HMRC dated 6 May 2005. The financial statements for SIRRnet for the period ended 31 March 2006 showed that SIRRnet was reliant on receiving funds from external sources in order to continue to trade. Note 7 of the statements stated:

"*Included in other loans is a loan due to Pickering Financial Services Limited of £565,002 (2005: £684,400). As part of the loan facility a debenture over all present and future assets of the company has been granted in favour of Highwater Properties Limited.*"

#### Turnover, Profits and Mark-ups

204. From commencement of trade in 2004 with an estimated turnover of £400,000 declared on the VAT 1 SIRRnet's trade escalated from the date of first taxable supply in January 2005 to August 2005 to £14,000,000 in net sales. Over the following 18 month period the turnover increased by over 407%.

205. Gandalf IT's turnover more than doubled from £12,727,744 in the year ending January 2005 to £28,760,625 in the year ending January 2006.

206. Gandalf Asia's total sales from 16 June 2004 to June 2005 were £128,520. Between July 2005 and May 2006 the sales grew to £14,930,730.

207. In each of the deals carried out by Gandalf Asia and Gandalf IT, the Appellants made a far larger profit exporting the goods than was made by the buffer traders. In Gandalf IT's deals 1, 2, 3, 4, 5, 7 and 8 the buffer traders made consistent mark-ups regardless of the quantities, specifications or price of the phones. The profits made by the buffer traders in the chains up to Multisystems Technology were consistently 75p,

35p, 75p, 50p and 50p. Multisystems Technology always made £2 per item in each deal in April 2006 and either £3 or £3.50 per item in each deal in May 2006. Syskal always made between £1 and £2. Gandalf IT always made a profit of between 3.25% and 3.59% save in deal 6 where 19.05% was made.

5 208. In Gandalf Asia's deal 2 there are discrepancies between the prices shown on the invoices and the actual payments made by traders which were traced by HMRC officer Kenneway, more about which we will say in due course.

209. Ms Yeomans noted that in every deal Gandalf Asia and Gandalf IT purchased from Syskal even though its prices were higher than those of other traders in the chain, for instance in deal 7 Gandalf IT purchased 8,000 Sony Ericsson phones from Syskal for £2,416,000 when it could have purchased the same from Multisystems Technology for £2,400,000. Ms Yeomans queried why this was the case when Multisystems Technology and Gandalf IT shared premises and had a connection via Mr Dawson.

15 210. In cross examination Ms Gellvear also highlighted that in one of SIRRNET's deals the goods were split (transcript day 1 page 53):

*"Q. In your subparagraph (e) I think you say that if you look at the deal sheet and your paragraph, you say, as we can see from the deal sheet, that the goods were split?"*

20 A. *That's right.*

*Q. I think you say that could be understood if the goods were to go to separate customers?"*

25 A. *Right.*

*Q. You say the goods were sold to SIRRNET on the same day?"*

A. *That's right.*

30

*Q. If you look at the deal sheet, the goods did go to separate customers, didn't they, they went to Berkshire and High Level Trading?"*

A. *They went to SIRRNET's separate customers, but not to Syskal's separate customers. They went to SIRRNET which was the same customer.*

35

*Q. Yes, but SIRRNET sold the goods to two different customers.*

A. *They did but Syskal sold them to one.*

40

*Q. Yes, so it's possible, isn't it, that because it was administratively easier, SIRRNET placed two separate orders with Syskal?"*

A. *Why would Syskal split them if they were selling to the same customer? I think that was my point. The goods had been split at Syskal; how would they know Sirnnet were going to split them to different --*

5 *Q. I am asking you to speculate here, but it's possible that Sirnnet said to Syskal: "We want X of that and Y of that"?*

A. *I don't know, Mr Holland."*

10 The goods

211. All of Gandalf Asia's deals and Gandalf IT's deal 6 were for CPUs:

Deal	Product	Date of Invoice	Units sold by GI or GA	Unit price paid by GA or GI	Unit price at which sold by GA or GI
GA deal 1	SL7Z9 P4 3.0/800 2mb	2 June 2006	18,900	£75.50	£78.00
GA deal 2	SL7Z9 P4 3.0/800 2mb	6 June 2006	8,190	£75.50	£77.50
GA deal 4	SL7Z9 P4 3.0/800 2mb	12 June 2006	15,750	£73.50	£75.50
GA deal 5	SL7Z9 P4 3.0/800 2mb	6 June 2006	15,750	£75.50	£78.00
GI deal 1	SL7Z9 P4 3.0/800 2mb	8 May 2006	10,710	£84.25	127.67 Euros

212. Evidence was provided from Mr Milner at Intel Corporation confirming the accuracy of a statement provided by his predecessor Ms House in which it was confirmed that Intel's worldwide price list for 2006 showed a price for the models traded by Gandalf Asia and Gandalf IT of US\$180 in May to July 2006. Mr Milner confirmed that there was no reason why Intel would have supplied such CPUs at a discount for distribution through wholesalers.

213. Mr Milner also confirmed (transcript day 4 page 10):

20 *"Q. ... Within your knowledge, is there a grey market for Intel CPUs?"*

A. *Yes, there is. Yes.*

*Q. Was there a grey market in 2006?"*

25

A. *Yes, there was."*

## Inspections

214. The inspection reports for SIRRNET's April 2006 deals revealed that some of the boxes containing trays of goods were damaged, although Ms Gellvear conceded in oral evidence that there was no evidence to suggest that the goods themselves were damaged. Ms Gellvear noted the absence of evidence to demonstrate that SIRRNET had made any enquiries as to the type or level of damage and queried why SIRRNET's customer had apparently sought no redress in this regard. The inspection reports also indicated that the goods were checked against a "stolen" list. Ms Gellvear queried who had compiled the list, the source of the information and what action was taken if goods were matched to those on the list. Ms Gellvear also noted that it was not clear on the face of the report what an inspection actually consisted of. In cross examination Ms Gellvear stated (transcript day 1 page 64):

15 *"Q. You refer to the stolen list, which again is in the top right-hand corner of the report at B6/1. He says the reports appear to indicate the check had been undertaken but it does not indicate he compiled the list of stolen CPUs."*

A. Yes.

20 *Q. Did you ask Forward that question?*

A. I didn't, no.

*Q. Any particular reason why not?*

25 A. I would have -- if I had been SIRRNET, I would have like to have known a bit more about the stolen list I think.

*Q. But the report is prepared by Forward though, isn't it?*

30 A. It is, yes.

*Q. So they are more likely to know the answer to that, aren't they?*

35 A. There's no evidence that SIRRNET asked them though either."

215. HMRC noted that only three inspection reports have been provided for the 15 deals carried out by Gandalf Asia and Gandalf IT despite Mr Rowlands claiming that reports had been obtained on all deals.

216. HMRC also noted that the inspection report provided in respect of Gandalf IT's deal 8 is for a different type of phone than that shown on the invoices; the invoice relates to 8000 Sony Ericsson phones whereas the inspection report refers to 8000 Nokia 8800s.

## Due Diligence

217. Ms Gellvear noted that Sirnnet failed to provide any evidence during the course of the extended verification in respect of due diligence checks undertaken on the freight forwarders it used. In the absence of such evidence she concluded that Sirnnet entrusted high value goods to freight forwarders about which they knew nothing and that had not been appointed directly by Sirnnet but rather had been chosen by its immediate supplier. Although due diligence documents had been provided in the course of these proceedings Ms Gellvear queried the benefit that the limited due diligence would have provided to the company.

218. In respect of its supplier Syskal, Mr Ryder had informed HMRC in correspondence that no due diligence had been carried out save for verification of the VRN via HMRC's Redhill department. Ms Gellvear noted that the requests for validation had taken place on the same dates as the transactions which meant that the response from Redhill had not been received until after the deals were completed. However in cross examination Ms Gellvear accepted that Redhill checks had been undertaken for all deals save where validation could not be given by HMRC, for example where the Appellants' customer IT Swiss was based in Switzerland.

219. HMRC noted that KPMG's Trading Procedures Report prepared for Syskal and dated 21 December 2005 provided extensive guidance on recommended due diligence methods. In particular the report highlighted the need to check, verify and confirm information and the importance of undertaking independent checks. It was submitted that there was no evidence to demonstrate that such procedures had been followed. In particular there was a notable absence of visits to trading partners, checks were conducted very close to or after the date of the transactions and negative indicators highlighted by documents such as Dun and Bradstreet reports were ignored.

220. Sirnnet provided HMRC with due diligence carried out on its customers in respect of which Ms Gellvear made the following observations:

- High Level Trading GmbH: The company was newly formed and a Dun and Bradstreet report dated 4 April 2006 obtained by Sirnnet showed the company as "an above average level of risk." The first contact with High Level appeared to documents dated 5 April 2006 (which was also the date of the first deal) yet a trade reference obtained from Nicole Compton in Las Vegas was dated 4 April 2006. Ms Compton indicated that she had only been dealing with the company for 6 months.
- IT Swiss Systems: A Dun and Bradstreet report dated 13 December 2005 indicates that the risk could not be assessed as the company was newly formed and the financial situation of the company could not be determined. No further financial enquires appeared to have been undertaken by Sirnnet. A Graydon check dated 10 March 2006 rates IT Swiss Systems as a "medium risk" but also stated that information as to how the company "meets its liabilities is not readily available" and there is "not sufficient information available at present to be able to give a definite assessment of the financial situation." The report also stated that contact could not be made with the director on his private number and that IT Swiss Systems together with other companies sharing the

5 same director had no official telephone connection. No further checks appeared to have been undertaken by Sirnnet as a result of the Graydon report. A trade reference from Somatra SA (a freight forwarder) dated 2 September 2005 indicated that it had traded with IT Swiss Systems for 5 months however the company had only been incorporated for a period of 4 months at the date of the reference.

- 10 • Berkshire International (“Berkshire”): A Dun and Bradstreet report dated 30 May 2006 post dated Sirnnet’s first deal with Berkshire on 5 May 2006. The report did not assess the financial strength of the company as it was newly formed. The names of two trade referees were provided by Berkshire however there was no evidence that Sirnnet had taken up references. A document confirming Berkshire’s bank account details was dated 1 July 2006; Ms Gellvear queried the use of the information for deals which had taken place in May 2006. On Sirnnet’s customer application form the director of Berkshire declared that the company was incorporated in April 2004 however all third party documents relating to the company indicate that it was registered as a company in April 2005; there was no evidence that Sirnnet queried the discrepancy in dates.
- 20 • Freshnet International (“Freshnet”): Information obtained from a website called “Infogreffe” showed the company’s business activities as “intermed comm en machines, equipments industrial, navires, avions” The Dun and Bradstreet report shows the trading activities as “motor vehicle wholesalers; construction and mining equipment wholesalers; farm and garden machinery and equipment wholesalers; industrial machinery and equipment wholesalers and industrial supplies wholesalers”. None of the documents indicated that the company wholesaled computer chips. An account application form signed by Freshnet was signed and dated on the date of Sirnnet’s first transaction with the company. The Dun and Bradstreet report indicated that there was insufficient information upon which credit worthiness could be assessed although the report goes on to state that Freshnet offers a significant level of risk, has lower than average financial strength and a higher than average risk factor. A reference from Freshnet’s accountant was dated 17 July 2006 which post dated the deals undertaken in May 2006.
- 35 • GTC Sarl (“GTC”): Europa and Redhill checks on 8 May and 17 May 2006 respectively post dated Sirnnet’s first trade with the company on 5 May 2006 and a response to a Redhill check made on 5 May 2006 was not received prior to the trade. No evidence was provided to demonstrate that Sirnnet took up any of the three trade references supplied by GTC and a Dun and Bradstreet report dated 4 May 2006 stated that there was insufficient information to offer a credit opinion and that GTC represented a significant level of risk. Ms Gellvear also queried the use of documents written in French dated 29 September 2005 which pre-dated the transactions by over 7 months.
- 40 • GiGa ASIA PTE (“GiGa”): Two Dun and Bradstreet reports were provided dated 23 March 2006 and 15 May 2006. Ms Gellvear queried the use of the



earlier report which pre-dated the trade by 3 months. The company which is based in Singapore was shown to have a director with a UK address and the risk assessment was “slightly higher than average.” A customer declaration form was signed and dated 30 June 2006 which post dated the deal which took place on 14 June 2006. There was no evidence that either of the two trade references were taken up by Sirnnet. Details of a visit to GiGa by Ms Ridley of PFS stated that the information collated was “limited as director was currently away on business” and the premises could not be inspected.

221. Ms Yeomans outlined the due diligence checks evidenced by Gandalf Asia and Gandalf IT as follows:

- Syskal: A checklist showed that the certificate of Incorporation, VAT registration details, letter of introduction, bank account details and a Companies House search were obtained. The checklist was dated 10 August 2006 which was 4 months after the first transactions. A Dun and Bradstreet report was also obtained which showed Syskal as a high risk of business failure and advised that guarantees should be obtained if credit was given. A trade reference for Syskal which had been requested by PFS dated 13 July 2005 was also produced together with a trade application form completed and signed by Mr Rowlands dated 26 January 2005. The Companies House report dated 11 July 2006 showed the director as Mr Gould and the company secretary as Mr Pickering who were both, along with Mr Rowlands, shareholders of PFS.
- GSM: A certificate of incorporation, registration certificate, headed paper, letter of introduction and bank details were obtained. A Dun and Bradstreet check was made on 10 August 2006, after the date of the relevant transactions. It indicated that GSM was a high risk of failure, had been recently established and had a weak financial position. GSM’s trade application stated it had commenced trading in October 2005. The application was recorded as faxed on 27 April 2006 (the day before the deals) but included two documents dated July 2006.
- IT Swiss: A certificate of incorporation, letter of introduction, trade reference from freight forwarder Somatra and customer declaration were obtained. A Dun and Bradstreet check was dated 10 August 2006; four months after the relevant transaction had taken place. The report showed a financial strength of 50 to 90 Swiss Francs (between £38 and £69) and a high level of risk. A Graydon report dated 10 March 2006 showed the company as medium risk, although it noted that there was insufficient information to provide a definite assessment, and noted that there was no official phone connection.
- GTC Sarl: A certificate of incorporation, registration certificate, letter of introduction, customer declaration and Companies House search were obtained. A Dun and Bradstreet check dated 10 August 2006 (which post dated the first transaction by three months) showed a higher than average

financial strength and higher than average risk with insufficient information available to provide a credit opinion.

- 5 • GiGa Asia: A certificate of incorporation, letter of introduction, bank account details and Companies House search were produced. A Dun and Bradstreet check dated 10 August 2006, which post dated the last relevant transaction by two months, was unable to provide a rating due to lack of up to date figures and gave a credit risk level of slightly higher than average.
- Of the five freight forwarders used, due diligence checklists were provided in respect of three which post dated the relevant transactions.

10 Nature of trade, movement of monies and release of goods

222. HMRC noted that the Appellants were willing in each deal to export and release the goods before full payment or a deposit was received. In Sirnnet's 6 deals in April 2006 all of the goods were released prior to payment save for one deal (deal 5) in which the goods were released on the date payment was received. It was further noted  
15 by HMRC that Syskal usually received payment only after Sirnnet was paid by its customer.

223. HMRC highlighted the fact that none of the chains could be traced to an end user or retailer. The Appellants' customers were wholesalers and their suppliers were not manufacturers which gave indications as to the length of the chains of supply which  
20 were not queried by the Appellants. The transactions took place back to back with none of the members of the supply chains taking physical possession of the goods. HMRC drew attention to the fact that all of the deals were conducted on the same day and queried how there had been sufficient time to negotiate the deals, agree on terms and arrange inspections and insurance. There were no written contracts in place  
25 which raised the question as to how a party could seek redress in the event of faulty or damaged stock, or the wrong items being supplied. Some of the mobile phone deals involved 2-pin chargers that were not readily usable in the UK making it unclear why an arm's length vendor would not have sold them directly to European customers.

224. HMRC submitted that the members in Sirnnet's supply chains are remarkably  
30 consistent; sometimes several supply chains contain precisely the same members in the same order. Other supply chains contain the same members in a different order or only include one or two different members. HMRC submitted that this was indicative of contrivance as such coincidences would not be found in legitimate arm's length transactions.

35 225. HMRC noted that the Appellants added no value to the supply chains yet significant profits were achieved.

Analysis of money flows

226. HMRC officer Kenneway analysed data from the FCIB which showed the movement of monies in samples of each of the Appellant's transaction chains. By way

of example, in Gandalf IT's transaction on 28 April 2006 (invoice number 1276a) the movement of money was circular:

Gandalf IT > GSM > Brandsite > Macdelta > Performance Specifications > High Speed > Fortwell > Multisystems > Syskal > Gandalf IT.

5 227. Mr Kenneway found that the paper invoice chains and the payment chains did not match; from the FCIB data the importer appeared to be Performance Specifications whereas the invoice chain showed the importer as Park Supplies. On the basis of the movement of money, Park Supplies would not have been in a position to pay its VAT liability as it never received payment for the goods. The invoice chain  
10 also showed SS Enterprise in Germany as a participant in the chain yet it did not appear in the payment chain. Mr Kenneway also noted that all of the transactions were conducted in Sterling irrespective of where the trader was based.

228. Mr Kenneway's evidence can be summarised as follows:

- 15 • Gandalf IT: In 7 of the 8 deals analysed circularity of payment was found. In the remaining deal one of the traders (IT Swiss) did not bank with the FCIB which broke the chain. Funds were transferred within a short space of time, for example in deal 4 on 5 May 2006 the main movements of funds between 9 FCIB accounts took place in just over 2 hours. In all 8 deals third party payments were made abroad which bypassed the defaulting trader and first  
20 buffer trader. Gandalf IT, based in Richmond, used a common IP address with Syskal, based in Manchester. Other traders in the chain, such as Macdelta located in Spain and GSM based in the Netherlands also used common IP addresses (deals 1 – 5 inclusive).
- 25 • Gandalf Asia: Circularity of payment was identified in all 5 deals. All of the transactions took place in Sterling and third party payments were made abroad which bypassed payments to the defaulting trader and first line buffer trader. Gandalf Asia and Syskal used a common IP address to make the payments as did other traders in the chains such as Sundial (based in the UK), Fone Dealers (based in the UK) and Intertech Sarl (located in France). The time periods  
30 within which payments were made were short, in some deals circulating around the whole chain of 9 traders within 24 hours.
- 35 • Sirnnet: Circularity of payment was identified in all 13 of Sirnnet's May deals. All of the transactions took place in Sterling and the funds were transferred within a very short space of time. Third party payments were made abroad which bypassed payments to the defaulting trader and first line buffer trader. A common IP address was used by Sirnnet (located in London) and Syskal (based in Manchester). Other traders also used common IP addresses, for example in deals 2 and 3 Fluid Trading Ltd (located in Denmark) and Freshnet  
40 International Ltd (located in France). In deal 3 the invoices in respect of the transactions were all dated 5 May 2006 yet payments were made by all participants in the deal on 9 and 10 May 2006.

229. Mr Holland challenged that circularity was present on the basis that some of the payments traced by Mr Kenneway were not sequential. In cross examination Mr Kenneway clarified his methodology as follows (transcript day 1 page 101, 109, 124 and 131):

5     *"I didn't trace an exact sum of money because obviously as goods move from trader to  
trader there was always a slight difference in the sums of money. So whenever I  
was tracing the UK, I looked at the invoice amount for each transaction and  
traced the amount to that invoice amount and again looking at the FCIB  
10     transaction statements to verify that the actual amounts that I was identifying  
were the ones that did actually apply to that deal. As far as being in Europe  
goes, obviously I didn't have the invoices or transaction sheets so, again, I  
looked to see if I could find a narrative that actually linked the deals with the  
actual transactions so I could tie the two together.*

15     *Q. If you are trying to show circularity, isn't it important to show that, for example, A  
pays to B and then B receives that and pays to C, rather than A pays to B but  
before B has received A's payment, A makes a payment to C?*

20     *A. When I was doing this, I didn't actually tie myself up to that at that point. I really  
looked to see: could I actually just find the money moving around? If there was  
collusion and fraud and everyone was aware of it. It wouldn't really matter  
when they paid because they all knew they would be -- you know, they would be  
certain of getting their money but I was more concerned with seeing whether I  
25     could actually trace the money flow and then after that I looked at the dates and  
times.*

30     *A....at the beginning it's my best judgment but when the Paris server material became  
available I looked at the Paris server narrative and quite often that narrative  
made references to the actual goods that were being dealt in and quite often it  
was possible to tie the actual quantity and the type of goods to the actual  
payments.*

35     *Q. If you don't tie yourself to dates and times you can always prove circularity, can't  
you?*

40     *A. You cannot prove circularity if the money does not go to another trader. You  
know, over the years, I haven't worked in VAT, but I used to work in direct tax  
and special civil investigations and going through bank statements there,  
looking for amounts of money. You know, quite often the money goes to lots of  
different places. You know, it's not easy to show the amounts going, but in these  
transactions there are amounts of money going around from trader to trader  
and the amounts of money are very similar and quite often equate to the invoice  
amounts. And I wouldn't have found that in other exercises I've been given. So  
45     I do believe there is circularity of the funds irrespective of the dates and quite  
often the funds do move within 24 hours from trader to trader, from out of  
Europe and into the UK and back out to Europe again."*

## Insurance

230. HMRC was provided with two policies of insurance cover. One was provided by Ms Evans at a meeting with HMRC on 18 September 2006 in respect of the Gandalf companies. Cover was provided by Zurich through the brokers Abbot and Bramwell Ltd. HMRC noted that the terms for the insurance are unclear; the policy appeared to provide 12 months cover from 1 October 2005 and gave a limit of £2,000,000 on goods at specified locations including Forward Logistics, Humber Freight, Paul's Freight and Hawk Precision. The policy did not appear to cover the other freight forwarders used by the Appellants and cover was limited to £1,000,000 at non-named locations. HMRC highlighted that on 28 April 2006 Gandalf Asia sold £6,639,500 worth of goods, of which £5,482,500 worth were located at Interken and therefore did not appear to be covered to the full value. There was also a limit of £1,000,000 per vehicle applied for goods "in the ordinary course of transit" yet Gandalf IT's May 2 and May 3 deals which were carried on one vehicle both exceeded the limit.

231. Sirnnet provided an incomplete policy (2 pages of 21 were produced) from Willis Ltd which made no reference to a time period, conditions or extent of any cover.

## Criminal Investigations

232. HMRC officers Downer, Kerrigan and Cummins provided evidence regarding a criminal investigation which began in February 2005 called Operation Apparel. Between 15 and 18 August 2006 following the execution of search warrants, a series of diaries and notebooks were uplifted from premises in the North West of England which contained handwritten details of approximately 650 MTIC fraud transactions in CPUs. Mr Kerrigan explained in oral evidence (transcript day 2 page 64):

“Q. ...As part of the seven-year investigation, was anything from Sirnnet or Gandalf detained, interviewed, charged?”

A. No, the people that were charged were the people who were effectively running the fraud itself. In other words, the main men behind it, not the actual brokers involved, not the buffers. Just purely the people that were behind the fraud.

Q. So nobody from Gandalf or Sirnnet was interviewed as part of your investigation?

A. Not to my knowledge. But what I might want to clarify is that the investigation Operation Apparel was into the mobile phone side of the fraud. So effectively we had no interest in the CPU side of the fraud because the gang that we were looking at -- rather than say criminal associates, let's call it a gang -- were based in Glasgow and Manchester. So the 129 million, as I say that we were going to indict on was on the mobile phone side. The CPU side was of no interest to us. So Gandalf, from what I know, were only involved in the CPU side. In fact I didn't know anything about a Gandalf until such time as the diaries were -- I was asked to provide a witness statement for the diaries.

*Q. Right.*

*A. So they wouldn't have been interviewed, no.”*

233. Ms Cummins identified the diary entries which related to transactions undertaken by Sirnnet. A number of examples were set out in full in her witness statement, two of which specifically included the abbreviation “SIR” found in two diary entries which was deemed to refer specifically to Sirnnet. Ms Cummins also summarised a further six transactions in which Sirnnet featured albeit the company was not specifically named in the diary entries as the list ends prior to the company’s involvement. The identities of the traders’ names found in abbreviated form in the diaries was confirmed by Mr Bagnall (in his witness statement provided for POCA proceedings in the Crown Court) to be those applied by HMRC following analysis of the diaries and deal sheets.

234. It may be helpful at this stage to set out a summary of one of those examples. One handwritten entry is entitled “Thur 4/May” which was taken to mean 4 May 2006 on the basis that during the years 2002 to 2009 the only year on which 4 May fell on a Thursday was 2006. Other diary entries which specifically refer to 2006 support this conclusion. Under the date the words “26Z9s @ Point 8190 UNITS” appear which describe the goods traded and number of units dealt with (i.e. 26 boxes of Z9s which is 8190 units according to the industry standard of 315 CPUs per box). Below the goods are a series of abbreviated names and numbers which were believed to be the prices. Towards the bottom of the transaction chain the abbreviation “SIR” appears alongside 82.25. Comparisons between the diary entries and HMRC’s Electronic Folder helped to identify the trader associated with the abbreviation; in the case of “SIR” the trader was Sirnnet.

235. Ms Cummins compared the diary entry to the deal sheets held by HMRC over 4 and 5 May 2006. The deal sheets showed that MI supplied Syskal with 8190 Pentium 4 CPUs for £82.25 which were sold by Syskal to Sirnnet for £82.75 each. The diary entry above “SIR” showed the abbreviation “MSYS” which was taken to be one of the Multisystems companies. As Ms Cummins compared the deal sheets with the abbreviated names and prices she found that the information matched save for the presence of Syskal in the chain which was not seen in the diary entry. Ms Cummins provided the following helpful tables which clearly show the information found in the diaries as compared to the information known to HMRC:

35

	<b>HMRC</b>	<b>DIARY</b>
<b>DATE</b>	4 – 5 May 2006	Thur 4/May
<b>GOODS</b>	SL7Z9s	Z9s
<b>QUANTITY</b>	26 boxes / 8190	26Z9s/8,190 Units
<b>FREIGHT FORWARDER</b>	Point/Humber	Point

TRADER (HMRC)	TRADER (DIARY)	PURCHASE (HMRC)	PURCHASE (DIARY)	SALE (HMRC)	SALE (DIARY)
	HL				
	INT		89.25		88.50 – 89.50
	PZP		89.50		79.90
	CW		79.90		80.30
MG	Mg		80.30	80.50	80.50
Optimal	OPT	80.50	80.50	80.70	80.70
Emmen	EM	80.70	80.70	81.00	81.00
Multisystems	MYS	81.00	81.00	82.25	82.25
Syskal		82.25		82.75	
Sirrnet	SIR	82.75	82.25	85.75	
High Level					

236. As can be seen from the table above, the companies and prices which featured in the diary tallied with the information held by HMRC in respect of the transaction. The diary also contained additional information by which HMRC was able to identify additional traders in the chain such as Causway Initiatives (“CW”), PZP ENA (“PZP”), Eurl Intertech (“INT”) and High Level Trading (“HL”).

237. Ms Cummins also noted that the relevant diary extract contained numbers and company abbreviations which suggested that third party payments were made:

10 INT – 730 012.50

Mg – 5773.95

W – 38 885.17

(W was identified as Worldwide Currencies, a money service bureau.)

238. Ms Cummins explained that the diary entry suggests that Optimal made third party payments and that MG Components took a small amount from the payment (5773.95) with the remainder going to “INT” and “W”. The deal sheets show that MG Components made a net sale of £659,295 with VAT at 17.5% of £115,376.63 thereby

giving a gross figure of £774,671.63. That gross figure matches almost exactly the total of the three figures above: 730 012.50, 5773.95 and 38 885.17 (£774,671.63).

239. Ms Cummins also noted that Sirrnet's customer, High Level, also appeared at the start of the chain which is further evidence that the transactions were pre-ordained.

5 240. HMRC officer Kerrigan provided further regarding the diary entries with  
reference to the analysis of HMRC officer Downer. He noted that there are a number  
of examples whereby Syskal and Bytel are not shown in the diary entries but appear  
on the deal sheets between Multisystems and Sirrnet. A similar pattern was also found  
when Mr Kerrigan analysed the diaries in respect of transactions undertaken by  
10 Gandalf Asia. He noted that in the Gandalf Asia deals the diary entries show "4%"  
next to Multisystems which appeared to be the allowable profit for the broker trader.  
If this analysis is correct, profit could be spread amongst other traders so long as the  
4% was not exceeded.

15 241. Mr Kerrigan explained that a laptop seized from an address in Manchester was  
found to contain spreadsheets which in some cases mirrored the handwritten diary  
entries. His analysis of the spreadsheets strengthened his view that traders could be  
included in chains of supply so long as the total profit allowance was adhered to. By  
way of example one deal on 12 April 2006 showed a buying price for Syskal in the  
diary as "82" with no selling price shown. Syskal sold the goods to Sirrnet for £82.50  
20 and Sirrnet sold the goods to High Level at £85.25. The profit of Syskal and Sirrnet  
taken together is £3.25 which is a 4% profit on Syskal's buying price.

#### *Evidence on behalf of the Appellants*

242. We heard evidence from two witnesses on behalf of the Appellant; Mr Rowlands  
and Mr Van Praagh. We were also provided with a witness statement from Mr Rogelj  
25 who was the director of Sirrnet during the relevant period. We were told, and we  
accepted that Mr Rogelj was unable to attend to give evidence as he currently lives  
and works in Austria and he was neither willing nor able to attend. In any event, Mr  
Rogelj's evidence was limited to confirmation that the Sirrnet deals which form part  
of this appeal had taken place and he exhibited documents such as purchase orders  
30 and invoices in support.

243. Mr Rowlands provided witness statements in respect of each of the Appellant  
companies which he expanded upon in oral evidence. We will not repeat the contents  
set out therein in any great detail but the salient points can be summarised as follows.

#### Business model and funding

35 244. In or about the early part of 2005 it was decided, together with the injection of  
loan capital from Highwater, to restructure the business. The business model was  
designed to take advantage of ring-fencing (which we understood to mean the need  
for each company to be protected from any adverse financial risks incurred by the  
others). Due to the fact that export businesses can only operate if the exporter has  
40 funds that could be tied up in input VAT until repayment is made, for commercial  
reasons a trader may have to cease trading until that repayment is made by HMRC. It



was therefore incumbent on the directors of the Appellant companies as part of their fiduciary duty to do whatever was legally possible within their capacity to obtain the VAT repayments as soon as possible. It was therefore decided that in order to keep the VAT value down more than one export company would operate at the same time.  
5 As this involved extensive paperwork and organisation it was decided that each company should have a separate director who would be the principal employee and a nominal shareholding of 5% in each company would be given to each director.

245. In cross examination Mr Rowlands explained that advice had been taken from KPMG (transcript day 5 page 35):

10 "A. *We took advice from KPMG on how best to achieve tax advantages.*

*Q. Yes.*

*A. And on stability.*

*Q. Yes.*

*A. On their view on the market generally and how best to --*

15 *Q. Yes.*

*A. -- structure the business so --*

*Q. Are you suggesting that KPMG told you that this was the best set-up for your business or are you saying that's one of the things you discussed with them?*

*A. It's one of the things we discussed. There would have been a number of -- we  
20 would have sat down with them and told them what we wanted to achieve and they would have come up with a suggestion on structure.*

*Q. You see, we'll, if we need to, look at the KPMG report in due course but can I suggest this to you: that there is nowhere in the detailed and lengthy KPMG report where they suggest this structure at all?*

25 *A. Which report? We had numerous reports.*

*Q. You mentioned a KPMG report, did you not? So did they advise you at all that this was the best structure, that Syskal be at the head of the pyramid siphoning products to either SIRRNET or Gandalf who then sell on?*

*A. I forget the detail of the documents, but we paid KPMG over a period of time to  
30 produce many reports for us.*

*Q. I see.*

*A. So I am not sure what specific report you are referring to.*

*Q. All right. We have only been given one of the many reports you refer to."*

246. The new structure was that Syskal would carry out the UK to UK business with the other companies being separate export businesses. The investment from the investors was subject to PFS carrying out due diligence procedures and the investment was conditional on the export companies purchasing goods from Syskal. In oral  
5 evidence Mr Rowlands stated (transcript day 5 page 43, 48 and 52):

*“Q. Yes. So why have SIRRNET and Gandalf at all? Why not just have Syskal, the way you were, happily trading before this new structure? Syskal buys, there's no risk about five people being (sic) Syskal sells. What's wrong with that?”*

10 *A. Well, we just set up five companies. When you do something you set up a company and --*

*Q. I see. All right.*

15 *A. If it was five...*

*Q. But the way you've set up this system is that Syskal is at the bottleneck, so suddenly you've got two separate companies, SIRRNET and Gandalf, that may be in trouble and they're passing their troubles straight up to Syskal, who are at  
20 the top of the pyramid, do you see?*

*A. Yes, but clearly if -- you know, if a customer doesn't pay, it's a problem...*

25 *Q. All right. Would you accept this as a proposition: that the relationship between the group of companies, by which I mean Syskal, Gandalf Asia, IT, SIRRNET and the others in the group, which I'll come to --*

*A. Yes.*

30 *Q. -- the relationship between them was such that the trading activity of any one in that group was affected if the trading activity of any others was affected?*

35 *A. I think the question that you're asking me is probably simpler than that, in that if we don't have a company that pays us or HMRC don't pay us, then we have a cash flow issue within the group and quite clearly that affects everyone.*

*Q. You're right. And so if I put it even simpler than that: if there's a problem at the bottom it goes to the top, which is Syskal and Pickering?*

40 *A. If we've got a cash flow problem, we've got a cash flow problem.”*

247. The practice of taking loans to finance exports is a legitimate business practice. The director of Crestvalley was an investor in Mr Rowlands' business rather than a friend. The shareholders of Syskal acted as the guarantor for the loan to Gandalf IT as  
45 they were the majority shareholders in both companies. Mr Rowlands was not aware as to whether PFS was able to guarantee loans; it was rather that PFS was the vehicle through which loans were made to the trading companies by the investors.

248. In cross examination Mr Rowlands could not explain how it came about that Crestvalley, who had provided the initial loan to Syskal, went on to introduce Highwater to Mr Rowlands which led to finance being provided by Mr Van Praagh through Highwater at a much lower rate of interest (9.5% as opposed to 20% charged by Crestvalley) (transcript day 5 page 26):

*"I think initially Crestvalley introduced Highwater to us or --...And then the relationship developed --..."*

10 *Q. So Crestvalley, who were getting about 20 per cent return on their investment --*

*A. Yes.*

15 *Q. -- introduced Syskal to Highwater, who eventually agreed less than half of that interest rate; was that correct?*

*A. Approximately, yes.*

*Q. That wasn't an odd introduction for Crestvalley to make?*

20 *A. It wasn't for me to question who they introduced us to, really. I am happy to go to a meeting and discuss whatever they want.*

25 *Q. It was a gift, wasn't it, because you're suddenly paying half the interest rate or less than half the interest rate you've been paying?*

*A. I am not sure whether "gift" would be the word.*

*Q. All right, that's my word, I agree.*

30 *A. Absolutely, yes.*

*Q. You tell me how you see --*

35 *A. It was another meeting, that's all.*

*Q. Well, you tell me how you see an introduction by someone who is getting 20 per cent from you introducing to someone who is going to charge you less than 10 per cent.*

40 *A. That wasn't the purpose of the introduction.*

*Q. Ah, what was the purpose?*

45 *A. It was just a meeting to -- my understanding was that they did business together and --*

*Q. I see.*

A. -- out of respect for the relationship I was happy to have the meeting.

5 Q. As it happened, shortly after that meeting Syskal were interested in a finance agreement that would result in a 9.25 per cent repayment?

A. I think it took some months but, yes.”

10 249. Mr Rowlands went on to confirm that he could not recall if the unlimited guarantee document in respect of the loan of £2,000,000 had ever been signed He was also asked if he was “good for” that amount at the relevant time and replied “I don’t think I would have been at that point, no” (Transcript day 5, page 78).

250. Mr Rowlands provided the following explanation of the usual practice in the market dealing with the purchase of large quantities of a single item:

15 “Trader A is going to a huge bankruptcy auction or has heard about a large quantity of stock someone has just imported. Trader A will contact Trader B who he knows is a major wholesaler of stock. The conversation usually goes like this: Trader A, I have stock do you want it? Trader B, how much stock do you have? Trader A, how many do you want? Trader B, at the right price I will take whatever you can get me. They  
20 agree on a price. This conversation will almost never happen on the day the deal takes place as, if Trader A is good at his job, he would have set up the deal a few days before the auction. Then, Trader A has to bid at the auction at the maximum price that will give him the ability to sell the whole stock to Trader B at the negotiated price or negotiate with the importer a price that will make it worth while for him. Then, what  
25 is usual is the date on Trader A’s paperwork for his purchases will very often, if not always, be dated the same day as the sales. Trader A has turned over the stock on the same day.”

Awareness of fraud, due diligence and links between companies

30 251. It was accepted that the Appellants had a general knowledge that there was “some fraud within the industry.” However it was not accepted that the Appellants knew or could have known that the transactions were connected to fraud.

252. In oral evidence Mr Rowlands explained (transcript day 5 page 9, 11 and 12):

35 “Q. So when was your first involvement in large-scale buying or selling of CPUs or mobile phones?

A. I think it was when we set up Syskal Distribution.

Q. I see. And Syskal Distribution was set up in late 2004, was it?

40 A. I think so, yes.

Q. Did you quickly come to the conclusion that these were shark-invested waters when you're dealing with high volumes of mobile phones and CPUs?

5 A. I think business generally is -- is, you know, the skills are transferable, aren't they? If you're buying something and selling it to try and make a profit there is always someone out there who is trying to stop you from doing that.

Q. You weren't aware that you could have people that you're dealing with that may cease to be in existence within a day of trading within them?

10 A. No.

Q. You weren't aware that further up the chain there may be people who disappear without paying their VAT?

15 A. It's impossible to be aware of something that you're not aware of so, no, I didn't know that, no.

Q. So you, by the time Crestvalley invested in your business, believed that you were in an industry which was no different from any other business?

20 A. No, I think it was the same principles to any other business applied.

Q. What about MTIC fraud? Did you think your business in high volume CPUs and mobile phones particularly attracted MTIC fraudsters?

25 A. Well, we -- when we started the company we'd never heard of MTIC fraudsters, so --

30 253. Mr Rowlands clarified that the transactions which form the subject of this appeal took place over one year after Mr Dawson had been bought out. Mr Dawson had no connection with the Appellants after he ceased to be a director on 29 April 2005 other than being a supplier known to them. The relationship with Mr Dawson was strictly "*business to business*" and at the time the VAT1 for MT was filled in, Mr Dawson had already become disassociated with the Gandalf companies which traded from other offices within the same business centre. Mr Dawson was a trusted supplier with longstanding and was therefore a preferred choice. Multisystems were at arm's length. In oral evidence Mr Rowlands clarified that he had been introduced to Mr Dawson by Mr Gould.

40 254. It was decided that due diligence checks between the companies themselves would not be necessary. KPMG was instructed to devise the trading and due diligence procedures and to advise on the manner of trade. In an email to HMRC dated 18 November 2004 (which referred to a meeting with HMRC on 10 November 2004) Mr Rowlands stated:

45 "...we were very pleased to show the level of work that we have done in conjunction with KPMG with a view to achieving full and extensive compliance and due diligence

*on our suppliers and clients on a deal by deal basis... We were even more pleased to hear that you were very impressed with our due diligence...*

255. It was unnecessary to carry out due diligence on Syskal as it was part of the group of companies connected to the Appellants. Mr Rowlands agreed that “Syskal  
5 *knew Multisystems*” and stated that “*as the two companies were different legal entities, it was understood that HMRC would not accept that, in May 2006, “as both directors knew each other”, the companies did not mutually need all the due diligence paperwork carried out.*”

256. In respect of the relationships between the companies Mr Rowlands stated  
10 (transcript day 5 page 90):

*“Q. All right. Now Mr Rogelj at the same time as running Sirrnet was also involved in a company called Manatlantic, was he not?”*

15 A. *Yes.*

*Q. You would have known that because you would have done your due diligence checks on Mr Rogelj, because you wouldn't have wanted to take on a director of a company, Sirrnet, that might have also been in direct competition with the group, would you?*

20 A. *Maybe not, no.*

*Q. Maybe not?*

25 A. *I am trying to remember the exact relationships. As I said, it is eight years ago. I know you've gone through this in detail but I haven't so --*

*Q. But as a business you would not want to take on someone who could be running a company in direct competition to yours, would you?*

30 A. *I think the answer to that question would probably remain on the finance, because if you have sufficient contracts or customers available then you're limited to the amount of deals you can do anyway.*

35 *Q. All right. Now, Manatlantic -- and Mr Rogelj was a director of Manatlantic -- were trading in March 2006 and in June 2006.*

A. *Okay.*

40 *Q. They were in fact trading in March 2006 and June 2006 with GigaAsia?*

A. *Okay.*

Q. So this is Mr Rogelj, a director of SIRRNET, a company that you and your friends have now effectively taken over, who is running a company in March and June 2006, Manatlantic --

5 A. Yes.

Q. -- that is directly trading with the very company your companies are trading with?

10 A. Okay...I can see that there potentially would be issues, yes. I can only think that because they would have had a certain amount of finance available that they would only do a certain amount of deals anyway.

Q. I see. So that was your hope?

15 A. I wasn't aware of all this, so --

Q. I see.

20 A. So, you know, Steve would have been doing whatever he does with Igor and --

Q. You wouldn't have checked before bringing Mr Rogelj into this what other directorships he had?

25 A. No.

Q. You wouldn't have checked that he's a director of Manatlantic?

A. No.

30 Q. No? Therefore the fact that he might be in direct competition had not entered your thought process?

35 A. It's not a case of entered thought process. I mean, you meet people and if you know them and trust them anyway then there is -- you know, you take a view on it at the time."

257. A number of additional due diligence documents were adduced by Mr Rowlands, for example terms and conditions with customers and checks undertaken on freight forwarders. His written evidence stated that that IMEI numbers of (which uniquely identify each individual item or device) were not kept due to concerns over scanning inaccuracies. However in cross examination Mr Rowlands subsequently stated (transcript day 5 page 188 and 191):

45 "Q. And therefore the best way, and possibly the only way, to guard against the round and round and the stolen phones is to have a proper list of IMEI numbers?

A. Yes, which we did.

Q. *Where are they? We've been served -- when I say "we", on our side of the fence we have been served with one set of numbers on a number of A4 sheets of paper for one deal.*

5 A. *Um. (Pause)*

Q. *Where are they? Where would they be?*

A. *In your documents I don't know.*

10

Q. *All right. No, where would they be in your documents?*

A. *Well, I haven't seen any, so --*

15 Q. *But you say that you did keep them?*

A. *Our IT manager internally bespoke a system which kept a record of every single CPU trade box that we bought and every single phone as well...*

20 Q. *Your response at your paragraph 59: "IMEIs were not kept because of concerns over scanning inaccuracies." Explain that sentence to me, please.*

A. *I can't. I don't remember saying that but I have signed the thing so ... We had a system where we kept IMEIs and we kept everything, so I can't -- maybe Robert could help with that but I can't."*

25

258. Mr Rowlands referred to the Appellants' "*standard due diligence procedures*" although he accepted he was not involved in actually carrying out such checks and that he had been unaware, by way of example, that the Appellants' customer GTC had a director, Mr Timothy Mason, whose main occupation was running campsites in France (transcript day 5 page 147):

30

*"Q. Mr Mason said that he had lived in France for several years. His main occupation had been running camping sites." Does that ring any alarm bells with you, if you had known that?*

35

A. *If we had known that then --*

Q. *And he gave his mother's address who lives in Newport Lane in Lincoln.*

40

A. *Okay.*

Q. *"Mr Mason claimed that he had no previous experience in the operation of the mobile phone trading business." Are the alarm bells now deafening?*

45

A. *Well, it is all news to me. I didn't know that, so I am just seeing this now.*

Q. *No, if you knew that then would the alarm bells have been ringing very loudly?*



A. *Yes, we would probably have done more due diligence than we would ordinarily have done and for some customers, for example, we would send KPMG out to visit premises and do due diligence on companies.*”

5

259. Redhill requests for validation of VRNs were regularly made however due to delays responses were often only received after a transaction had taken place. Records of verbal validations were made by the Appellants.

10 260. As regards insurance Mr Rowlands accepted that on the face of the documents exhibited a risk existed on the basis that the goods may not have been covered in transit by one vehicle due to their value exceeding the terms of the cover, stating (transcript day 5 page 157): “...*I actually don’t know as we sit here.*”

15 261. In response to the evidence of Ms House from Intel, Mr Rowlands explained that the discount of approximately 19% at which the Appellants sold CPUs is not a large discount; much larger discounts from manufacturers’ list prices can be obtained in sectors with grey markets and for some commodities purchased at bankruptcy auctions discounts of between 50% and 90% are attainable.

#### Mark-ups and payments

20 262. Mr Rowlands clarified that credit was not given by the Appellants; stock was released on payment and credit reports were therefore obtained to enable company details to be cross-referenced rather than to check credit worthiness. Goods were shipped on hold and as the Appellants and Syskal were jointly owned companies there was a justified level of trust between them.

25 263. Mr Rowlands disputed in his written evidence that the mark-ups achieved by the Appellants were indicative of contrivance. Sirnnet had no idea what mark-ups were made by Syskal or by Multisystems: “*Indeed the Company did not know that Syskal was buying stock from Multisystems.*”

#### Inspections

30 264. Mr Rowlands believed that inspections had been carried out on all the goods traded. He noted the concern by HMRC that reference was made to damaged boxes but clarified that the CPUs themselves were not damaged. In his written evidence he stated:

“*These computer chips were destined for computer builders who were not interested in the packaging...*”

35 265. Mr Rowlands subsequently went on to state in his written evidence that it is accepted that the Appellants’ suppliers were not manufacturers and their customers were not end-users. On the issue of why the companies imported 2-pin European mobile phone chargers that would not be saleable to end-users in the UK, he was only able to suggest that these might have been imported in error and then re-exported.

When cross-examined on that point he denied that such a feature “rang any alarm bells” (Transcripts, day 5, page 217-8).

266. Mr Rowlands accepted that the colour of the goods was important as it would affect price. In respect of anomalies between the documents regarding colour he stated (transcript day 5 page 213):

5 *“Q. What is Sirmnet purchasing?”*

*A. It says here "Nokia 8800 black".*

10 *Q. Okay. Why do you emphasise "black"?”*

*A. I guess that was the colour that was requested by the customer...*

*Q. Is that an inspection report?*

15 *A. It is.*

*Q. What was inspected?*

20 *A. 8800 -- it doesn't mention colour.*

*Q. Are you sure?*

25 *A. Oh, stainless steel. Yes.*

*Q. Oh dear. So no doubt someone would have spotted that and returned the goods?*

*A. Or called the customer and told them and said, "Do you want them? They're not black."*

30 *Q. And they would have kept a note of that, wouldn't they, because otherwise the customer will say, "I ordered black," and no one has a note of that phone call to say, "We're actually selling you stainless steel"?*

35 *A. No, you're correct but someone would -- as soon as we realised that they were a different colour, someone would have called them. In this case it would have been Steve would have called them and said, "They've turned up and they're not black they're stainless steel. Do you still want them?"*

40 *Q. So Mr Timothy Mason, our tent man again, has signed a document accepting the black phones?*

*A. Yes.*

Q. *So no one seems to have phoned him because if they did he might have said something on that form saying, "They're not black, you just told me it's stainless steel"?*

5 A. *I understand what you're saying, but, you know, typically if someone sends someone -- if when they had faxed this to him, I don't how much notice he would have taken of the black or not, but --*

Q. *But I thought you said black is important?*

10

A. *Well, it is, yes. I don't know whether they were black when they went there or whether they were stainless steel and the freighter made a mistake. I don't know...*

15 Q. *And again, if I suggest to you that those sorts of -- not exactly that but a number of anomalies crop up again and again on inspection reports.*

A. *Mm."*

20 Evidence of Mr Van Praagh

267. Mr Van Praagh gave written and oral evidence in his role as the main board director of Highwater which was chosen as a director for the Appellants by the administrators due to Highwater being the only beneficiary of any potential liquidation surplus.

25 268. Mr Van Praagh has been a property investor since the 1960s and over the years has built up a substantial portfolio. He has also gained personal experience in a wide range of business activities. During the relevant period Highwater was in a sufficiently strong financial position to provide the liquidity needed to invest in the Appellant companies. At the time, Highwater could not find suitable property  
30 investments and was seeking other investment opportunities.

269. A close friend of Mr Van Praagh's, Mr Spielman mentioned that a company called Crestvalley whose director was Mr Schwinger had invested money into a company owned by Mr Rowlands which was doing very well. Mr Van Praagh was told that Crestvalley was seeking syndicated loans to fund this onward investment to  
35 the Syskal companies. He could not recall asking Mr Schwinger what rate of interest he was receiving, but said he "must have" asked that question and thought that Schwinger might have been entitled to as much as 20% of the Syskal companies' profits. Mr Van Praagh visited Mr Rowlands and Mr Gould at Syskal and found the set-up was impressive. A number of people were employed in well maintained offices  
40 and the explanation of the business included a slideshow presentation. He was not told the company's turnover, but was told how deals were done, and got the impression, either then or from what he was told by his associate Moshe Kinn (see below), that customers paid for goods in advance, or only a few days after delivery: on that basis he decided that the commercial risks were minimised. Mr Van Praagh decided that  
45 rather than join a syndicate he wanted to invest directly. A "dry-run" loan was made

to Syskal via Crestvalley which, following repayment, led to Mr Van Praagh investing £2,000,000 into the Appellant group of companies.

270. One of the purposes of the loan in February 2005 was to enable repayment to Crestvalley. The terms of the loan included the understanding that it would be  
5 converted into a 50% holding in all the companies which utilised the funds when the appropriate documentation was drafted. PFS was formed to act as treasurer and it received loans from Highwater to loan to the group as required. The formal loan documentation extended beyond PFS to the ultimate users of the funds.

271. The City solicitors (Sprecher Grier) were appointed to draft the contract for  
10 transfer of 50% of the shares in the companies to Highwater, which was in draft final form at the time of the appointment of the administrators in 2006. The due diligence process was never completed with the result that Highwater only had a 14% shareholding in Gandalf IT, a 15% shareholding in Gandalf Asia and no shareholding in Sirnnet.

272. Mr Van Praagh's friend Moshe Kinn was appointed as a signatory to the Syskal  
15 group bank accounts as a way of protecting Highwater's interests prior to the transfer contract. Mr Kinn also attended the Appellant group's offices on an almost daily basis.

273. Mr Van Praagh was not advised by his solicitors about VAT fraud within the  
20 industry. He had not been aware of such problems and only became aware after the companies had ceased trading.

274. Mr Van Praagh explained that Mr Rogelj and Mr Ryder were unable and  
unwilling to give evidence on Sirnnet's behalf. It was also not possible to secure the assistance of Ms Evans to provide evidence on behalf of Gandalf Asia and Gandalf  
25 IT.

275. In oral evidence Mr Van Praagh explained that he had conducted due diligence before making the loan (transcript day 6 page 15):

30 *"A. I knew a gentleman locally, who was at that time a JP, a very capable man, and I paid him a reasonably large fee to interview Mr Rowlands in Birmingham and he must have spent three or four hours interviewing him -- Rowlands said he said he would never want to see the man again, he took his skin off. But I was satisfied with the report which this man, Mr Deutsch, made and that I relied on reasonably."*

276. Mr Van Praagh confirmed that he had "hardly any" knowledge of Mr Ryder or  
35 Mr Rogelj and was unaware that they were involved with another company which may have had conflicting interests by carrying out the same type of trade. He said that he had not carried out any due diligence as to whether Mr Rowlands' assets could support his £2m guarantee.

277. He stated that he had not been aware of VAT fraud in the industry prior to  
40 trading nor had he been advised by Mr Rowlands prior to making the loan about the

fact that tax losses within the Appellants' deal chains had been traced in earlier periods (transcript day 6 page 21):

“*Q. Did he tell you before you loaned the money that he had been told of tax losses within his deal chains in the period September 2004?*”

5

*A. I don't believe so. If any of them -- all your questions are such that no one would invest in a company.*

*Q. I agree.*

10 *A. It's being told by Marks & Spencer's that their burgers are horsemeat.*

*Q. I agree.*

*A. They would not buy those burgers; I would not trade with Mr Rowlands.”*

15

278. Mr Van Praagh confirmed that at the time of this hearing he was owed approximately £7,000,000 by the Appellants but said that he had not taken action to recoup the money. As far as he was concerned, he was investing in what he believed were profitable trading deals and because his associate, Mr Kinn, was in a position to control expenditure, he believed that it was simply a question of awaiting VAT repayments in order to get a return on his investment.

20

### **Submissions**

279. We were helpfully provided with written submissions by both parties from which we summarise the salient points.

25 *HMRC's Submissions*

280. In support of its case on knowledge or means of knowledge HMRC relied on the following:

- The Appellants' awareness of the prevalence of MTIC fraud at the relevant time through the Appellants and associated companies;
- 30 • The use of banking arrangements with the FCIB to enable swift transfer of funds between offshore accounts and the fact that all save one of the transactions took place in sterling irrespective of the domicile of the paying and recipient companies;
- Circularity of payments in 26 transactions conducted by the Appellants which  
35 form the subject of this appeal;
- The diary entries found in the notebooks seized in Operation Apparel which indicates contrivance in the deal chains of which all participants must have been aware;

- The association between Mr Dawson, Mr Bagnall and the Multisystems companies which were present in the Appellants' transaction chains, together with the fact that Mr Dawson was known to Mr Rowlands and had been a former director of the Gandalf companies, albeit prior to the relevant deals;
- 5 • The inter-dependence of the Appellant and associated companies and the trading model which was at odds with Mr Rowlands explanation that the companies traded in the manner in which they did in order to ring-fence commercial risks;
- 10 • The significant increase in the Appellants' turnover without any apparent value being added to the goods;
- The fact that the transactions took place on a back to back basis without any apparent commercial risk;
- 15 • The consistent mark-ups in the chains of transactions irrespective of make, model or quantity of goods traded and the fact that the Appellants were able to achieve such higher mark-ups than other traders without any obvious explanation;
- The mark-ups of Syskal and the Appellants when taken together in each deal where Syskal was supplied by one of the Multisystems companies were approximately 4%;
- 20 • The irregularities and unclear terms of insurance whereby the limits per vehicle in transit did not appear to have been adhered to;
- The limited inspection reports provided and the anomalies contained therein;
- The contradictory evidence given by Mr Rowlands as to whether IMEI numbers were kept;
- 25 • The absence of meaningful due diligence by the Appellants and the lack of any evidence to demonstrate due diligence carried out by Syskal as part of the Appellants' trading group;
- The absence of evidence from Mr Ryder, Mr Rogelj, Ms Evans and Mr Pickering from which we were invited to draw adverse inferences (citing *HMRC v Sunico A/S* [2013] EWHC 941 in support);
- 30 • The vague evidence of Mr Rowlands and his assertion, raised for the first time in cross examination that documents had gone missing which included signed copies of guarantees of the associated companies in respect of the Highwater loan and reports from KPMG which advised on the structure of the trading group and a review of the due diligence procedures;
- 35

- The financing of the Appellants through Crestvalley in respect of which no loan agreement was provided and no satisfactory explanation given as to why the funds were channelled through Syskal when they were intended for Gandalf IT;
- 5 • The financing by Highwater despite Mr Van Praagh's lack of experience in the trade sector and lack of any real awareness about the nature of the trading companies and the terms on which they traded. HMRC also drew attention to the inconsistent evidence given by Mr Rowlands and Mr Van Praagh as to whether Highwater was made aware of the existence of and extent of fraud within the industry;
- 10 • The loan terms in respect of the Highwater loan which did not provide any real security for the sum as Mr Rowlands and the Appellants had insufficient assets as security. HMRC also contend that the failure to transfer a 50% shareholding to Highwater within 18 months from the date of the loan letter lacks credibility as does Mr Van Praagh's evidence that he had not taken steps to recoup the money;
- 15 • The inability of Mr Rowlands to answer adequately questions regarding general commercial issues concerning the Appellant companies such as the potential conflict of interest for Mr Rogelj and Mr Ryder;
- 20 • The uncommercial trading method whereby goods were released to the Appellant's customer overseas prior to receipt of payment and prior to those further up the chains receiving payment which effectively meant that traders such as MT had lost control of goods;
- 25 • Anomalies in documentation such as the fact that the Appellants' inspection reports in two deals (SIR-M5 and GIT-M1) predated the request for inspection by their supplier Syskal;
- The fact that Syskal was requested to sign supplier declarations by the Appellants despite the close connections between the companies;
- 30 • The lack of evidence demonstrating any meaningful due diligence undertaken by Syskal on its suppliers;
- The lack of adherence to KPMG's Trading Procedures Report.

281. The Appellant's submission that HMRC's failure to investigate certain defaulting traders breached the principle of proportionality was misconceived; such matters are irrelevant to the issues that the Tribunal must determine in this case.

35 *Appellant's submissions*

282. It was submitted by Mr Holland on behalf of the Appellant that the general principles of community law, which are supported by the cases of *Kittel*, *Mahageben*,

*LVK* and *Stroy Trans*, make clear that a failure by a tax authority (in this case HMRC) to carry out its investigative tasks and to seek to transfer the consequences of that failure on to the taxable person precludes the refusal of the right to deduct and contravenes the principle of proportionality. The behaviour of HMRC is a relevant consideration for the Tribunal in this case in assessing the evidence before it.

283. In respect of the defaulting trader Knightswood, HMRC had grounds to believe that the company was involved in MTIC fraud yet over the course of approximately 18 months, during which period Knightswood failed to file returns, HMRC failed to take any action against the company such as de-registration. HMRC had been aware that the company was involved in third party payment instructions, that the director Mr Mahmood had a background of MTIC trading and that the company had been involved in fraudulent trading between August and November 2005. Not only did HMRC fail to exercise its powers but it also failed to monitor the company. Mr Holland submitted that HMRC's failure in this regard was a fundamental breach of the principle of proportionality.

284. Mr Holland submitted that HMRC had failed to discharge the burden of proof in respect of the tracing of the following supply chains which were challenged:

- Sirnnet deal on 14 June 2006 where there was no evidential connection between Fonedealers and Sundial. Ms Gellvear's evidence was that she had relied on Ms Cummins for the link; however Ms Cummins did not set out such a link in her witness statement. The chain was said to be traced back to Knightswood and evidence of a visit to Point of Logistics was exhibited in support of this contention. The visit report set out the link from Knightswood to Infnit Consultants to Sundial by using trader listings. There is no direct or indirect evidence linking Fonedealers and Sundial as neither Ms Gellvear or Ms Cummins could point to it. Ms Cummins stated in oral evidence that the diary entries, which are said to support the link, were not relied upon to make the connection.
- Gandalf Asia deal on 6 June 2006 which was not traced beyond Fonedealers which was said to be a buffer trader.
- Gandalf Asia deal on 9 June 2006 in respect of which HMRC Officer Okoro believed on the balance of probabilities that the deal could be traced to Knightswood but Ms Yeomans, who confirmed in oral evidence that she preferred to use only the direct evidence, could only trace the chain to Fonedealers as there was no direct evidence of a supply between Sundial and Fonedealers.
- Sirnnet May deal 5 which was said to be traced to Causeway Initiatives on the basis of the diary entries. The relevant diary entry makes no reference to Syskal and Ms Cummins accepted in her evidence that the abbreviation she had attributed to Causeway could be either "EW" or "CW".



285. As to the issue of knowledge, it was accepted that Mr Rowlands was not directly involved in the transactions which form the subject of the appeal nor did he have any direct knowledge about the due diligence obtained on customers and freight forwarders. It was also accepted that Mr Rowlands did not have direct knowledge  
5 about the contents of inspection reports, ship on hold instructions or Redhill verifications. A more active role was played in Syskal's purchases by Mr Rowlands but HMRC has not alleged that Syskal's purchases were connected to fraud and that the company, through its officers, knew or should have known of that connection.

286. Mr Holland noted that there was no evidence that the Appellants had traded in  
10 the same goods more than once and it was accepted by HMRC that validation requests were made to Redhill in respect of all of the deals undertaken in the relevant period. Responses to the requests were subject to delays and Mr Rowlands gave evidence that it was not commercial to wait for a response where deals were carried out on the same day as the request was made.

287. Goods were shipped on hold, insurance held and inspection reports obtained.  
15 Some of those inspection reports are now missing having been stored in various places over the last seven and a half years during which the companies have gone into administration and then liquidation. It would be unfair for the Tribunal to conclude that the documents never existed and the Appellant's explanation that they have  
20 simply been lost over the passage of time should be accepted.

288. The evidence regarding Mr Dawson is irrelevant to the Appellants; he was never a director or shareholder of Sirnnet and he resigned as director of the Gandalf companies in April 2005 which pre-dates the transactions under appeal.

289. In respect of profits, Ms Gellvear agreed in oral evidence that Sirnnet achieved  
25 widely different margins and therefore HMRC's reliance on this point as evidence of knowledge or contrivance is misplaced.

290. As regards Mr Rowlands' evidence, he answered as far as he could questions  
30 regarding loans from Crestvalley and Highwater. The reason for the loans and lack of security obtained in respect thereof were not matters within Mr Rowlands' knowledge but rather matters to be asked of those supplying the loans. Mr Van Praagh took a commercial risk which cannot be said to be evidence of contrivance.

291. In respect of insurance, the evidence showed that although Secure Freight was  
35 not listed as an approved freight forwarder on the insurance policy, the Appellants had exhibited due diligence checks undertaken on the company together with correspondence regarding its compliance with the insurer's security conditions. Furthermore, although Worldwide Logistics was withdrawn from the list of approved logistics providers, the Tribunal should conclude that after entering into the policy, the Appellants contacted the insurers regarding the approval of other freight forwarders.

40 292. As regards the potential conflict of interest between Manatlantic and the Appellants it was noted on behalf of the Appellants that Manatlantic was only

registered for VAT in March 2005, months after Sirnnet joined the trading group of companies.

293. We were invited to attach little weight to the evidence of HMRC officers Kerrigan and Cummins as it was opinion evidence based on diaries which formed the basis of a 12 year criminal investigation which led to no prosecutions or convictions.

294. Similarly we were invited to treat the evidence of Mr Kennaway regarding circularity of money flows with caution as he had conceded in cross examination that he “*did not really get tied up with the dates or the actual – or the EBR numbers when I was showing the circularity.*” Mr Holland submitted that Mr Kennaway had commenced his task on the basis that there was fraud and collusion, and therefore circularity must follow. He had ignored dates and times of payments by, in effect, starting with a pre-determined conclusion.

### **Conclusion**

295. We began by considering the issue of adverse inferences which we were invited by HMRC to draw in respect of the failure by Mr Ryder, Mr Rogelj, Ms Evans and Mr Pickering to give oral evidence. We had regard to *Revenue and Customs Commissioners v Sunico A/S* [2013] EWHC 941 which cited with approval the principles set out by Broke LJ in *Wisniewski v Central Manchester Health Authority* [1998] PIQR 324:

“...*the familiar four principles summarised by Brooke LJ in Wisniewski v Central Manchester Health Authority ([1998] PIQR 324, at p 340:*

*“(1) In certain circumstances a court may be entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action.*

*(2) If a court is willing to draw such inferences, they may go to strengthen the evidence adduced on that issue by the other party or to weaken the evidence, if any, adduced by the party who might reasonably have been expected to call the witness.*

*(3) There must, however, have been some evidence, however weak, adduced by the former on the matter in question before the court is entitled to draw the desired inference: in other words, there must be a case to answer on that issue.*

*(4) If the reason for the witness's absence or silence satisfies the court then no such adverse inference may be drawn. If, on the other hand, there is some credible explanation given, even if it is not wholly satisfactory, the potentially detrimental effect of his/her absence or silence may be reduced or nullified.” ...*

*What is true, however, is that the question of whether there is a case to answer does depend on the individual case and the allegations in question. If the court is to draw adverse inferences, they cannot simply be of a general nature; they must be specific*

*inferences in relation to specific pleaded issues. I am mindful that this is a case where very serious allegations of fraud have been made against the Defendants and, whilst this does not affect the standard of proof, it does have some bearing on my approach to the evidence and the burden on HMRC to prove its claim.”*

5 296. Having carefully considered the principles set out above we concluded that it would not be appropriate to draw any adverse inferences from the failure of the Appellant to call Mr Ryder, Ms Evans and Mr Pickering and we proceeded to determine the issue in this appeal on the basis of the evidence before us.

10 297. We should note that the witness statement provided by Mr Rogelj did not assist us in determining whether the Appellants knew or should have known that the transactions relevant to this appeal were connected to the fraudulent evasion of VAT and although we formed the view that Mr Rogelj, as director of Sirrnet, could have provided helpful evidence had he attended these proceedings, we did not draw any adverse inferences from his failure to do so.

15 298. However, in the absence of evidence from the Appellants’ company officers we were left with little or no explanation of the alleged anomalies and why certain documentary evidence is lacking. Mr Rowlands on his own admission had little to do with the day to day running of the Appellant companies and Mr Van Praagh had no involvement until after the period with which we are concerned save for provision of  
20 funds.

25 299. This seems an appropriate point at which to set out our assessment of the witnesses in this case. We found the HMRC officers were credible. We will not comment on each and every officer, but in particular we found Ms Gellvear was cautious to only give evidence within her own knowledge and was willing to accept points made by the Appellant where there was documentary evidence in support. Similarly we found the evidence of Ms Yeomans and Ms Cummins was reliable and not undermined by small errors highlighted in cross-examination. We found the evidence given by Mr Kenneway and Mr Kerrigan compelling and robust and we noted that Mr Kerrigan was frank to accept where his evidence of fact overlapped  
30 with his opinion. We should make clear at this point that we had no regard to subjective opinions expressed by the HMRC officers but rather we reached our own conclusions from considering the circumstances as a whole, for instance in respect of Mr Kenneway’s evidence which traced the money flows by reference to the FCIB data, we disregarded any statement of opinion expressed by him regarding the  
35 existence of fraud.

40 300. As we have already said, the evidence of Mr Rowlands was limited due to his lack of involvement in the Appellant companies. Even allowing for such a limitation, we found his evidence was vague, unconvincing and at times inconsistent. In respect of Mr Van Praagh, we formed the impression that he was an astute businessman who, it seemed had been misled through his ignorance of the business sector and an over-reliance on the potential profitability of his investment; we formed the impression from his oral evidence that the examples of deals shown to him at the presentation he attended may have been “white” rather than “grey” market deals and he seemed to

believe that the Appellant companies traded on terms that provided for payment in advance. Whilst we noted that Mr Van Praagh had carried out surprisingly little due diligence prior to making his investment and there were unusual features present such as the delay in implementing the share transfers, we concluded that this had little bearing on the issue for us to determine as Mr Van Praagh was not a company officer at the relevant time and had no involvement in the day to day running of the companies.

301. We found the evidence given by Mr Rowlands regarding the trading model of the Appellants unconvincing and artificial. His explanation that the companies were designed to achieve ring-fencing of commercial risks lacked credibility as it became clear in cross-examination that such a purpose was not achieved as a result of the reliance of the companies on each other and Syskal for trading purposes and the fact that the loan was cross-guaranteed against each others' assets. Furthermore, the structure offered no protection against the risk of a creditor default or purchase of wrong or faulty goods.

302. Even making allowances for the passage of time and Mr Rowlands' lack of involvement in the day to day running of the companies, we found his inability to recall the circumstances behind or substance of what was on his own account expensive advice from KPMG regarding the structure of the companies striking. Taken together with the absence of documentary evidence providing any clarification, we were unconvinced by Mr Rowlands' evidence.

303. The evidence in respect of the companies' trading methods was vague and unpersuasive. The assertion that the Appellants were afforded protection by the use of "ship on hold" instructions did not withstand scrutiny as there was no plausible explanation as to why such an expensive and potentially uncertain method was adopted which could have led to the need to repatriate goods in the event of non-payment.

304. Mr Rowlands' evidence on the issue of IMEI numbers was contradictory; having stated in his witness statement that IMEI numbers were not kept, he gave oral evidence that in fact there was a bespoke system in place designed to retain the numbers. Whilst we noted (and indeed it was accepted by HMRC) that there was no suggestion that the Appellants had ever traded in the same goods twice, the fact remains that the inconsistent evidence without any explanation served to undermine Mr Rowlands' credibility as a witness.

305. There were also other aspects of the appeal in which we found Mr Rowlands' credibility was undermined. Mr Rowlands challenged the note made by Mr D'Rozario set out at paragraph 177 above stating that he had no recollection of the conversation. We noted that the remainder of Mr D'Rozario's record was not challenged and having found Mr D'Rozario to be a credible witness we had no doubt that the conversation had been accurately recorded. Having made this finding, we noted that at about the time of, or very shortly after having indicated to Mr D'Rozario that he was contemplating leaving the trade sector, Mr Rowlands was in the process of negotiating a loan from Highwater; while telling Mr D'Rozario that he was thinking

of pulling out of the business because of supposed moral scruples, he gave Mr Van Praagh the impression that he was thinking in this way because he was running out of liquid capital. We also rejected Mr Rowlands' evidence that the Appellants were unaware from whom Syskal purchased; given the close associations between the companies which on the Appellants' own evidence rendered due diligence unnecessary, we found the assertion that Syskal's supplier was unknown to the Appellants wholly implausible. In our view these factors further undermined Mr Rowlands' evidence.

306. We were satisfied from the information provided by HMRC to the Appellants and the various records of conversations between HMRC and the company officers that they were fully aware of the general prevalence and characteristics of fraud within the industry, and it was against this background that we assessed the the Appellants' trading.

307. Mr Rowlands gave no satisfactory explanation as to why the companies were structured in the way that they were or indeed why there was a need for the three Appellant companies to effectively conduct the same trade. The conflicting interests of Mr Rogelj as a result of his involvement with Manatlantic were similarly left unanswered and there was no evidence that consideration had been given to this issue or indeed how it was practically addressed.

308. We were satisfied that the Appellants had close ties with Mr Dawson. Although his official involvement with the Gandalf companies had ceased prior to the period with which we are concerned, we noted that he was not only known to Mr Rowlands but that it was Mr Dawson's companies (either the Multisystems companies or Bytel) that supplied Syskal on all but three occasions. It was also Mr Dawson's office manager Ms Evans who took over from him as director of the Gandalf companies. When taken together with the fact that Syskal was, in reality, part of the vehicle through which the Appellants traded, we were satisfied that the transactions involving the companies associated with Mr Dawson were not arm's length, a fact which was known to the Appellants.

309. We found the substantial increase in turnover of the Appellant companies in circumstances where they added no value to the goods was such that any reasonable businessman involved in legitimate trade would have questioned why he was able to achieve such a substantial increase. The absence of any evidence that the Appellants queried this fact was in our view indicative of the fact that they either knew or turned a blind eye to the fact that its transactions were connected to fraud.

310. We also concluded that the general consistency in mark-ups achieved was indicative of the contrived nature of the deals. Again, there was no evidence before us to explain this feature or which demonstrated that the Appellants (and by its association Syskal) had entered into negotiations regarding price which would be expected in the course of legitimate trade.

311. The terms of the insurance cover were unclear in respect of the incomplete policy provided by Sirnnet and there was no other evidence provided by the company

to demonstrate what it believed the policy was or why the document provided to HMRC was incomplete. The document provided by Ms Evans, on the face of it, was not adhered to by the Appellants which suggested to us that they were aware that the transactions were contrived and “risk-free” such that insurance cover was redundant.

5 312. On the evidence before us we found that the due diligence undertaken by the Appellants lacked substance. Negative features highlighted in reports that were obtained, such as Dun and Bradstreet reports, were ignored and many of the documents obtained by the Appellants post-dated the relevant transactions and as such would have provided little in the way of comfort to the Appellants in assessing  
10 whether a deal was legitimate. We also queried why, when the Appellants and Syskal effectively worked as one trading vehicle, due diligence was undertaken on Syskal. We found Mr Rowlands’ explanation that this was simply a result of following standard procedure vague and unconvincing and we concluded that the only logical conclusion was that the due diligence undertaken was no more than window-dressing.

15 313. By way of example regarding the due diligence checks, Syskal requested verification via Redhill of Sirnnet in respect of its April deal 3a and 3b (which took place on 5 April 2006) on 13 April 2006. Sirnnet requested similar verification of Syskal on 5 April 2006, which it received on 6 April 2006. Gandalf IT sought verification of Syskal in respect of its April deal 2 (which took place on 28 April  
20 2006) on 3 May 2006 and Gandalf Asia sought verification of its June deal 4 on the date of the transaction (12 June 2006) and received a response on 13 June 2006. Supplier declarations which had been addressed to Mr Rowlands were also returned to the Appellants in respect of each deals and we queried why, given the structure of the companies this had been deemed necessary.

25 314. We found the inspection reports also lacked any meaningful substance and we noted that there was no evidence that anomalies clear on the face of the documents had been addressed. By way of example, in respect of Sirnnet’s April deal 2, the inspection report appeared to be addressed to Syskal. Similarly in Gandalf Asia’s June deal 2 the customer name on the inspection report was “Multisystems Int” which was  
30 not a company involved in the transaction; we found this supported our earlier finding that the Appellants and the Multisystems companies through Mr Dawson were not trading at arm’s length.

315. Further, in a number of cases such as Sirnnet’s May deal 4 no specification was recorded and we queried how Sirnnet knew the type of CPUs it had purchased and  
35 sold. In Sirnnet’s May deal 8 the goods purported to be purchased were black but the inspection report showed them as stainless steel. We found Mr Rowlands’ evidence that this type of discrepancy would have been addressed was unpersuasive given his admitted lack of involvement in the day to day operations and we noted there was no other evidence to support his assertion.

40 316. We noted Mr Rowlands’ evidence that some inspection reports had been lost. We found this evidence, which had not been raised prior to the hearing, unconvincing. Even if we accepted that this had been the case, Mr Rowlands was unable to provide any detailed information about the Appellants’ general practice in respect of

inspections and the anomalies within the documents we did see remained unexplained.

5 317. In spite of the lack of meaningful due diligence we noted that the Appellants were content to export the goods prior to payment. We were satisfied their willingness to lose control over the goods, for which they had not been paid and for which Syskal was aware it had not been paid, was indicative of their knowledge that the deals were contrived. In our view a reasonable businessman seeking to protect himself from unnecessary risk would not act in this manner, nor would he be willing to undertake the potential additional cost of repatriating the goods in the event that the transaction  
10 was not completed.

318. We did not find the Appellants' use of an FCIB account of itself helpful in assessing the issue of knowledge. Nor did we find that back to back trading was indicative of fraud or the Appellants' knowledge of such.

15 319. We accepted Mr Kenneway's evidence that circularity was present in all of the deals he had analysed. We did not accept Mr Holland's argument that circularity can only be established where payments are sequential; the circularity was in our view clearly established irrespective of the timings and dates of payments and we were satisfied that this indicated that the deals were contrived. Although we did not attribute knowledge of the wider scheme to the Appellant we were satisfied that the  
20 timings of payments did establish a close connection between the parties. We were also satisfied that it was unusual in the normal course of arm's length trading to see such short intervals between payments between purportedly independent traders in different geographical locations.

25 320. Similarly we were satisfied that the diary extracts relevant to this appeal were further indicative of contrivance. However we could not be satisfied that the inclusion of the Appellants indicated knowledge on their part of an overall scheme to defraud the Revenue.

## **Conclusion**

30 321. We considered *Mobilx* at [72] where Moses LJ referred to a number of important questions:

*"(1) Why was...a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?□*

35 *(2) How likely in ordinary commercial circumstances would it be for a company in [the Appellant's] position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone?□*

40 *(3) Was [the supplier] already making supplies direct to other EC countries? If so, he could have asked why [the supplier] was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.*

*(4) Why are various people encouraging [the Appellant] to become involved in these transactions? What benefit might they be deriving by persuading [the Appellant] to do so? Why should they be inviting [the Appellant] to join in when they could do so instead and take the profit for themselves?"*

5 322. We also followed the dicta of Briggs J in *Megtian Ltd v HMRC* [2010] STC 840 (*"Megtian"*) that there is no *"rigid prescription"* as to what HMRC must prove and we note the guidance of Moses LJ in *Mobilx* that the test should not be *"over-refined"*:

10 *"The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT...such circumstantial evidence...will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable award over a short space of time."*  
15 *(paragraphs 75 and 84).*

323. Having considered all of the circumstances of the transactions, we were satisfied HMRC had established fraudulent tax losses and that there was an orchestrated scheme for the fraudulent evasion of VAT connected with all of the transactions which form the subject of this appeal.

20 324. We took into account all of the surrounding circumstances in reaching our decision that the Appellants knew that its transactions formed part of an artificial scheme. We noted Mr Holland's argument that there is no direct evidence in this case; the fact that evidence is circumstantial does not mean it is to be ignored. Regularly in such cases only circumstantial evidence exists which can properly be taken into  
25 account in considering knowledge or means of knowledge. We concluded that the inferences that HMRC asked us to draw from all of the circumstances, which were compelling, became even more so in the absence of any rebuttal evidence from the Appellants and we were satisfied that the Appellants had actual knowledge that their transactions in this appeal were connected with the fraudulent evasion of VAT.

30 325. We found that some reasons carried more weight than others and we did not base our decision solely on one reason but rather the cumulative effect of our findings viewed in totality.

326. We also considered whether the matters relied upon by HMRC in support of actual knowledge could also support a finding that the Appellants should have known  
35 that their transactions were connected to fraud. Our findings of fact led us to conclude that there were sufficient indicators available to the Appellants from which they should have known that the deals were connected with fraud. Taking into account all of the circumstances of the transactions we were satisfied that the Appellants should have at least known that the only reasonable explanation was that they were  
40 connected to fraud.

327. The appeals are dismissed.



## **Costs**

328. We direct that the Appellants are to pay HMRC costs of, incidental to and consequent upon the appeals, to be the subject of detailed assessment if not agreed.

5 329. 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  
10 “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

15

**Jennifer Blewitt**  
**TRIBUNAL JUDGE**

**RELEASE DATE: 31 July 2014**