TC04304

Appeal number: LON/2008/00739

VALUE ADDED TAX – Denial of input tax recovery as connected with fraud –whether properly denied - On facts No – Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PRIVIN CORPORATION LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE ADRIAN SHIPWRIGHT
MS HELEN MYERSCOUGH ACA, ATII

Sitting in public at 45 Bedford Square, London, WC1 10-14 June 2013

Matthew Buckland, Counsel, for the Taxpayer

Charlotte Hadfield, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This decision concerns the appeal from the Respondent's ("HMRC") decision to refuse the Appellant, Privin Corporation Limited's ("Privin") claim for input tax credit of £1,100,765.75. The claim for input tax credit was made in respect of 9 transactions involving the purchase and sale of mobile phones in the VAT period 05/06.

2. The HMRC decision is contained in a letter dated 14 March 2008 ("the Decision Letter"). Privin appealed by Notice of Appeal dated 23 June 2008**.**

3. Privin's input tax repayment claims were denied because HMRC considered the transactions in question were part of an overall scheme of Missing Trader Intra-Community fraud ("MTIC"), which included the variation of MTIC fraud known as contra-trading and Privin knew or should have known of the connection with fraud when it entered into the transactions.

Procedural matters

4. There had been various applications made before the start of the hearing. However, at the start of the hearing we were told that there was no disputed application before us.

5. There had been a dispute as to whether the fourth witness statement of Mr Mandalia and the fifth witness statement of Mr Sanghrajka in response should be admitted. At the start of the hearing we were told that neither of the parties disputed that both of those statements should be admitted.

6. We gave permission for these documents to be admitted.

The Issue

7. In essence, the issue in this case is whether or not the input deduction was correctly denied.

8. This raised a number of questions including the following.

   8.1. D id the Taxpayer know that the Taxpayer's transactions had been or would be connected to fraud? Was there actual knowledge of fraud on the Taxpayer's part?

   8.2. S hould the Taxpayer have known that the only reasonable explanation for the transaction in which the Taxpayer was involved was that the transaction was connected to fraud? (See *Mobilix* [59]). Was there imputed knowledge on the basis of *Mobilix*?

9. In both questions the onus of proof is on HMRC (cf. *Mobilix* at [81]). This onus is on the civil standard of proof i.e. the balance of probabilities.

Common Ground

10. It was common ground between the parties that:

   10.1. The chains in the deals in question had been established;

   10.2. There was tax loss in the chains;

   10.3. The tax loss was caused by fraud.

11. It was not disputed that, in broad terms, the Taxpayer's officers were aware of the existence of MTIC and carousel frauds and their relevance to the VAT system. It was disputed that they knew or ought to have known of the connection to fraud in the circumstances under consideration here.

12. It was not disputed that the deals were "back to back" in the sense that they were arranged to take place essentially on the same day. The significance of this was a matter of dispute.

Abbreviations and Dramatis Personae

13. The following abbreviations and references to persons are used in this decision but as ever are subject to the requirements of the context.

13.1.		"D&B" Dunn & Bradstreet, the well-known credit rater
13.2.	"the Decision Letter"	the decision letter referred to in paragraph 2
13.3.	"The Directive"	the 2006 VAT Directive (Directive 2006/112/EC, 28 November 2006).
13.4.	"FMS"	FMS International Limited, a company incorporated the UK involved in the chains
13.5.	"HMRC"	the Respondent
13.6.	"MTIC"	Missing Trader Intra-Community fraud
13.7.	"Privin"	the Appellant, Privin Corporation Limited sometimes referred to as "Privin"
13.8.	"Silvertown Global"	Silvertown Global Limited, a Jersey based company run by Mr Dasani
13.9.	"the Taxpayer"	Privin
13.10.	"Veracis"	Veracis Limited, a UK incorporated company providing "risk management" services to clients who included Privin. This included financial and other checks
13.11.	"WHY"	WHY Systems Limited, a company incorporated in the UK involved in the chains

The Law

Statute etc.

14. The law in this area derives from the VAT Directive. It is currently set out in Title X of the Directive. At the time of the transactions in question by Privin it was found in Title XI of the Sixth Directive (77/338EEC).

15. Title X of the Directive is not supposed to have changed the position and so far as is relevant reads:

"Article 167

A right of deduction shall arise at the time the deductible tax becomes chargeable.

Article 168

In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;

(b) the VAT due in respect of transactions treated as supplies of goods or services pursuant to Article 18(a) and Article 27;

(c) the VAT due in respect of intra-Community acquisitions of goods pursuant to Article 2(1) (b) (i);

(d) the VAT due on transactions treated as intra-Community acquisitions in accordance with Articles 21 and 22;

(e) the VAT due or paid in respect of the importation of goods into that Member State".

16. The UK statutory provisions are found mainly in sections 24 to 26 VATA and Regulation 29 of the VAT Regulations 1995.

17. Section 24 VATA provides:

"24. (1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—

(a) VAT on the supply to him of any goods or services;

(b) VAT on the acquisition by him from another member State of any goods; and

(c) VAT paid or payable by him on the importation of any goods from a place outside the member States, being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him…

(6) Regulations may provide—

(a) for VAT on the supply of goods or services to a taxable person, VAT on the acquisition of goods by a taxable person from other member States and VAT paid or payable by a taxable person on the importation of goods from places outside the member States to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases;..."

18. Section 25 VATA provides:

"25. (1) A taxable person shall—

(a) in respect of supplies made by him, and

(b) in respect of the acquisition by him from other member States of any goods, account for and pay VAT by reference to such periods (in this Act referred to as "prescribed accounting periods") at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.

19. Section 26 VATA provides:

"26. (1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below".

20. Regulation 29 of the VAT Regulations 1995 provides:

"29. (1) Subject to paragraph (2) below, and save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable.

(2) At the time of claiming deduction of input tax in accordance with paragraph (1) above, a person shall, if the claim is in respect of—

(a) a supply from another taxable person, hold the document which is required to be provided under regulation 13;…

provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold, instead of the document or invoice (as the case may require) specified in sub-paragraph 30 (a)… above, such other documentary evidence of the charge to VAT as the Commissioners may direct".

Case Law

21. We were provided with copies of the decisions in a number of cases all of which we have read and carefully considered. These included the following.

(i) *Kittel v Belgium (Case C-439/04) Belgium v Recolta Recycling SPRL (Case C-*
(ii) *440/04) [2006] All ER (D) 69 (Jul)*
(iii) *Optigen/Bondhouse* (C-354/03), (C-355/03),(C-484/03) [2006] Ch 218
(iv) *S-B (Children)* [2010] 1AC 678 (Supreme Court)
(v) *Re B* [2009] 1 AC 11 (HL)
(vi) *HMRC v Mobilix Ltd & Others* [2010] EWCA Civ 517
(vii) *Megtian Limited v HMRC* [2009] EWHC 18 (Ch)
(viii) *Red 12 v HMRC [2009] EWHC* 2563 (Ch)7
(ix) *Blue Sphere Global Ltd v RCC* [2009] EWCH 1150 (Ch)*40*
(x) *HMRC v Livewire Telecom Ltd* [2009] EWHC 15 (Ch)45
(xi) *JDI Trading v CCR* [2012] UKFTT 642

The Evidence

22. We were provided with a significant number of volumes of documents. These were agreed bundles. No objection was taken to any of the documents in the bundle and they were all admitted in evidence.

23. We heard oral evidence from the following witnesses:
    23.1. Pankaj Mandalia;
    23.2. Graham Price;
    23.3. John Fletcher;
    23.4. Hari Mandalia;
    23.5. Kamlesh Sanghrajka
24. Witness statements were provided for these witnesses who were cross examined.
25. The Bundle included a number of other witness statements. These were from:
    25.1. Susan Okolo;
    25.2. Anthony Mullarkey;
    25.3. Malgorzeta Wanat;
    25.4. Kulvinder Kumar;
    25.5. Martin Evans;
    25.6. Stewart McCaskell;
    25.7. Clive White;
    25.8. Michael Downer;
    25.9. Rod Stone.
26. Only the persons listed at 23 above gave oral evidence. The other persons providing witness statements did not nor were they cross examined. It is hard to decide what weight to give to evidence that has not been tested by cross examination. Unless corroborated in some way or accepted by the parties we have not generally given such evidence great weight.

Findings of Fact

27. From the evidence we make the following findings of fact.

Mr Sanghrajka (Kamlesh Sanghrajka)

28. Mr Kamlesh Sanghrajka was the main individual behind Privin.
29. Before coming to the UK Mr Sanghrajka was in Kenya where much of his family was.
30. He said in oral evidence (which we accept):

"I was sent to the UK just on an exploratory basis in 1983 on behalf of the family. That is when we first bought our timber and merchants business and at that particular time the instructions were very clear as to we venture into business which you can sustain for a long period of time and which could sustain a family … So my mandate was reasonably clear … I could experiment and look at different fields, different businesses that we could be doing".

31. Mr Sanghrajka told us that he was not employed by a third party mobile phone wholesaler or a mobile phone retailer or any similar business before Privin. He said in all his employments he had always been a director or a shareholder in the companies concerned. He said in evidence "I have never actually worked for any other". We have no reason not to accept this. This included Canary Corporation.
32. Canary Corporation was formed in July 2000 and it closed in September 2001 It was formed, amongst other things, to be an export agent for companies in Kenya. Mr Sanghrajka also at that time identified that there was a market in Kenya for mobile phones.
33. Mr Sanghrajka told us (and we accept) that Canary Corporation acted for a number of industries including the mobile phone wholesale trading sector. Mr Sanghrajka came to identify the mobile phone wholesaling trade as an interesting sector during his various visits to Kenya and Eastern Central Africa and the Middle East. At that time the mobile phone industry was just getting started in that part of the world and it seemed to him to be the business that was growing at the fastest possible rate.
34. Mr Sanghrajka accepted that up to the point where Privin was incorporated his trading history consisted of a number of opportunities that he had spotted but in the event did not go in the way that he hoped they would. We have no reason to doubt this and so find. We find this as a fact.
35. He said this business experience provided him with a wide breadth of transferable skills vital to understand the complex nature of the mobile phone trading industry.
36. *Mr Sanghrajka's background and experience*

37. Going back some time Mr Sanghrajka joined the family business in Kenya. This family business was involved with clothing and then with tyre re-treading.

38. Mr Sanghrajka then worked in a bitumen production unit with other family members.

39. Mr Sanghrajka moved to the UK and started to work for a timber and builders merchants business. That company was then sold. He then set up three companies trading in Eastern Central Africa, which exported clothing and general merchandise. The basis of his coming to the UK is set out at [19] above.

40. Canary Corporation was then formed. As noted above this was in July 2000 and the company acted as an export agent for various industries including the mobile phone wholesaling trading sector.

Privin Corporation Limited ("Privin")

(i) *Incorporation, business etc.*

41. Privin was incorporated in England on 31 August 2004. Its business was described as "general trading, exports of telecommunication equipment".

42. In his witness statement, Mr Sanghrajka stated that Privin was set up by his wife and mother in 2004. He stated that it was one of a number of companies with which he was associated, and that "he spent 18 months prior to" trading in the mobile phone industry "conducting research, developing contacts and conducting small deals". We accept this evidence and so find as a matter of fact.

43. He told us the only reason for his wife and mother setting Privin up was because they were very superstitious, and "after having all these companies and not a lot transpiring at that time".

44. Mr Sanghrajka explained that the name "Privin" stems from the first three letters of his daughter's name and of his son's name.

45. Mr Sanghrajka agreed that the aim when he set up Privin was not to trade with the EU, it was to trade with Africa over the long-term.

46. *Research etc.*

47. As noted above Mr Sanghrajka said that he spent18 months before he started trading in the mobile phone industry conducting research, developing contacts and conducting small deals. We accept this evidence and find it as a fact.

48. Mr Sanghrajka told us (and we accept) that the process of identifying "a grey market opportunity" started back in Kenya when Mr Sanghrajka saw there was a market to send phones out to Kenya. Privin was then set up to start trading in this sector. The research that was done included research into the possibility of getting the grey market supplies for this in the UK.

49. We were told the research involved speaking to people, looking at the relevant websites and getting information as far as pricing was concerned, how the trades would be done and what sort of logistics would be needed. Mr Sanghrajka said he understood the mobile phone business at that time to be a very fast moving industry. In summary he said he "… made all the contacts via the website and just built up from there". We have no reason to doubt this evidence which we accept and we so find.

50. Mr Sanghrajka looked at websites and got information about prices and he decided that he would use Privin to start trading in the wholesale mobile phone business. This was similar to what he had done earlier with other businesses when he started dealing in clothing. He had "no idea who was dealing in clothing" so he "…had to just build up to the business from there". We have no reason not to accept this and so find.

51. Mr Sanghrajka accepted effectively, he came into the mobile phone business as a newcomer notwithstanding his time at Canary Corporation.

52. *Directors and Secretary of Privin*

53. At the time of incorporation, Mrs Harsha Sanghrajka was listed as Director and Mr Sanghrajka's mother as Company Secretary.

54. The Director of Privin at the relevant times was Mr Sanghrajka. He was appointed on 21 April 2006.

55. The Company Secretary at the relevant times was Mrs Harsha Sanghrajka. She was also appointed on 21 April 2006. She was and is the wife of Mr Sanghrajka. She took over from Mr Sanghrajka's mother.

56. Privin employed two full time staff. It is understood that one of these was Mr Sanghrajka and the other was Mrs Harsha Sanghrajka.

57. *Shareholdings*

58. The shareholders of Privin (at the relevant times) were:

Name	**Number of ordinary shares at £1 each**
Mr Sanghrajka	50
Silvertown Global	50

Loans and funding

59. Funding was injected into Privin by a company called Silvertown Global Limited.

60. There was a loan agreement between Privin and Silvertown Global, which purported to show that Silvertown Global lent Privin a total of £1,175,000.00. This is broken down in the following amounts:

Amount £	**Date of Loan**
300,000	29 March 2006
100,000	23 May 2006
100,000	24 May 2006
675,000	9 July 2006

61. No capital repayments have been made on the loan, which is said to be repayable on demand. Only quarterly interest repayments at 4% over bank rate have been made.

62. Mr Mandalia made enquiries of Privin's tax representatives as to the nature of the relationship between Privin and Silvertown, and was told that Mr Sanghrajka was introduced to them through connections in Kenya.

63. Mr Sanghrajka said in his witness statement that he was introduced to Silvertown through contacts in Kenya and family members and has a strong relationship with them. He also said that the purpose of the loan was "to inject capital into the company in order to finance the start-up of the business and trading". We have no reason not to accept this and we so find as a matter of fact.

Silvertown Global

64. Silvertown Global is a company based in Jersey run by a Mr Dasani who is based in Malawi. Mr Dasani was the beneficial owner of Silvertown Global, although seemingly a trust structure was in place to hold the shares.

65. Mr Sanghrajka had known Mr Dasani for almost 20 years through family contacts but this was the first time that he had lent money to Mr Sanghrajka or his businesses or arranged for money to be lent to Mr Sanghrajka or his businesses in the UK.

66. Silvertown Global owned 50 per cent of the issued share capital of Privin. Mr Sanghrajka told us it was because of this that Silvertown were prepared to make the capital injection as they were hoping to share the profits it would allow to be generated. We have no reason not to accept this and we so find.

67. Mr Sanghrajka told Counsel for HMRC that he persuaded Silvertown ("them") to make the loan by telling them that there would be profits that would justify the large injection of capital. Mr Sanghrajka told us he had a business plan which was explained to Mr Dasani when they met in Kenya.

68. The business plan was slowly to build up the company and its capital so that in the longer term once Privin Corporation had built up enough capital the plan was to have a distribution within the UK. It would buy large quantities of the phones and then bring them to its

warehouse and then send out small quantities to different parts of the world. This was not a written business plan. Mr Sanghrajka explained it orally to Mr Dasani.

69. Mr Sanghrajka had approached Mr Dasani and Silvertown Global since Privin was formed. It was done during his various visits to Mr Dasani. They were always looking for business opportunities and there was an ongoing discussion as to what could be done, what should be done and how it should be done.

70. A letter dated 23 March 2006 from Mr Chatfield, who was the trustee of the trust which owned Silvertown Global, said that they were prepared to advance £500,000 to Privin. Privin had been trading somewhat albeit at a low level before that.

71. The money was needed at that time because at that time Mr Sanghrajka told us he saw potential business which could be done in April 2006 which required capital. We accept this and so find.

72. This was Mr Sanghrajka's evidence on this aspect. We have no reason not to accept this and we so find as a matter of fact and to the extent possible as a matter of primary fact.

73. Counsel for HMRC in effect suggested that this was uncommercial. The following exchange took place during cross examination.

"Q. So this is a situation where Mr Dasani is agreeing to advance your company half a million pounds?

A. Yes.

Q. On the basis effectively of a conversation.

A. Yes, numerous conversations.

Q. So you had not shown him any documents?

A. No.

Q. Would you not normally expect that somebody who was prepared to lend you that sort of money would want to see some documentary evidence of your business plan?

A. Not from my experience in our culture and being brought up in Kenya with the small communal divisions … it is all in trust and their faith in us".

74. We accept Mr Sanghrajka's evidence on this aspect and so find as a matter of fact .

75. Mr Sanghrajka accepted that Mr Dasani was aware of his personal trading history and that as at this stage he was not really able to demonstrate a sustained trading success in respect of any of the previous sectors that he had been in.

76. He continued "…but we have family". He accepted that although Mr Dasani was not a member of his family he has a business relationship with Mr Sanghrajka's cousins. Mr Sanghrajka said "…when he actually gave me the money he was looking at the background of the entire family and not just me…" and was hoping to make money.

77. Mr Sanghrajka accepted that "The whole agreement is on the basis that there are no structured capital repayments.

78. He was asked:

Q…You do not have to pay it back in instalments?

A. No, purely because that was his commitment to the business.

Q They can demand it at any time?

A Yes, but there would not be much point in them demanding it unless Privin had substantial assets to meet it, would there?

Q At the time that you entered into this arrangement with Mr Dasani Privin did not have substantial assets?

A. No".

We accept this evidence and so find as a matter of fact.

VAT Returns and Turnover

79. Privin was on monthly returns for VAT.

80. The returns submitted between 2005 and 2007 demonstrate an increase in turnover from 2005 to 2006, followed by a decrease from 2006 to 2007.

81. The following figures are taken from Mr Mandalia's summary of Privin's monthly turnover as disclosed on its VAT returns from its first return in period 05/05 to its last return in period 12/07 set out in his First Witness Statement. These figures were not disputed and we have no reason to doubt them. On that basis we accept them.

Year	**Privin's Turnover £**
2005	297,915
2006	7,987,222 (*of which £6,505,070 relates to 05/06*)
2007	152,048

82. The figures show a spike but that of itself does not show in these circumstances that the only explanation for the transactions was fraud. Equally of themselves they do not show that it was "too good to be true" and we so find and to the extent we can we do so as a matter of primary fact. We do this on the basis of the evidence that was before us in this particular case. Each case has to be decided by reference to its own circumstances.

The Deals in question

83. There are 9 transactions in issue in this appeal, undertaken between 16 May 2006 and 30 May 2006. Deal Sheets were produced for each of the relevant transactions are found in the Bundle.

84. As HMRC pointed out "In each transaction, Privin purchased mobile telephone handsets from UK-based suppliers and exported those same goods to customers based in other EU member states". We accept this and so find.

Table of Deals in Question

85. A summary of these deals is set out in the following table. This is derived from HMRC's submissions and was not disputed.

No	**Date**	**Supplier**	**Customer**	**Product/Units**	**Input tax repayment claim (£)**
1	16/05/06	LBS Warenhandel	FMS International	Nokia E60/ 2250	99,618.75
2	22/05/06	WHY Systems Ltd	Compagnie Internationale de Paris	SE 1900i /2000	101,850.00
3	22/05/06	WHY Systems Ltd	Compagnie Internationale de Paris	Nokia 9300i/ 1800	92,295.00
4	24/05/06	WHY Systems Ltd	Compagnie Internationale de Paris	Nokia 9300i/ 3000	154,875.00
5	25/05/06	WHY Systems Ltd	Compagnie Internationale de Paris	Nokia 9300i/ 2400	123,900.00
6	25/05/06	WHY Systems Ltd	Compagnie Internationale de Paris	Nokia N91/ 2000	120,050.00
7	26/05/06	New Ora Ltd	Cell Dot Com Middle East	Nokia 6680/ 4000	97,300.00
8	30/05/06	WHY Systems Ltd	Compagnie Internationale de Paris	Nokia N80/ 3500	205,187.50
9	30/05/06	FMS International Ltd	Cell Dot Com Middle East	Nokia 6230i/ 2520 And Nokia 3230/	59,314.50 and 46,375.00

				2000	
TOTAL					**£1,100,764.75**

Awareness of MTIC

86. It was common ground that "…in broad terms, the Taxpayer's officers were aware of the existence of MTIC and carousel frauds and their relevance to the VAT system. It was disputed that they knew or ought to have known of the connection to fraud in the circumstances under consideration here.

87. Mr Sanghrajka said that HMRC "did not help very much in terms of how to spot MTIC fraud". He said in evidence "Apart from the Notice 726, there was not anything else that was said to me which in any way I could identify fraud in either my supplier or my customer".

88. Mr Sanghrajka accepted that MTIC was discussed with him at the first visit from HMRC in 2005.

89. Mr Sanghrajka did not think it would be an odd situation if a particular trader always had the stock and nobody ever got there before Privin on the website because they offered it to Privin first. They offered it via fax to Privin as opposed to advertising it. He did not know if they did advertise or did this with others but the stocks were offered to Privin once he had built a rapport. We have no reason to doubt this and so find.

90. We find as a fact and to the extent possible as a primary fact that Privin and its officers were aware of the existence of MTIC and carousel frauds as a general matter.

91. We find as a fact and to the extent possible as a primary fact that Privin was not involved in actual fraud and the circumstances were not such that, at the time, the only reasonable explanation for the transactions in which Privin was involved was fraud.

Process

92. Mr Sanghrajka was the person proactively contacting suppliers and customers.

93. Mr Sanghrajka told us he would usually start by identifying an opportunity and get stock offers. This was as a result of being in regular contact with the relevant people by phone, fax, website etc. He went on to say: "I would then look to contact a customer for the mobile phones from a range of sources."

94. He agreed he would start by identifying stock that was on offer and then would try and match a customer to that stock.

95. He said that in two of the deals "…the customer actually came up to me and said he needed more of a particular type of phone". Usually the position was as described above.

96. He told us he "…would then call round the customer base that I had which I knew I had done work on as far as due diligence and that was concerned, speak to them on the phone, give them an indication of price and quantities that were available and then do a negotiation on the price".

97. He told us the sellers did not ask him whom he intended to sell to. He said "They do not ask because even if they did ask I will not tell them". We accept this and so find as a matter of fact.

98. Mr Sanghrajka accepted that he might choose a customer who happens to be part of the fraud. However, this does not mean that he or Privin was involved in the fraud or that the only reasonable explanation for the transactions was that Privin was involved in fraud.

99. Mr Sanghrajka did not agree that it is actually quite hard to see in retrospect how the fraud could work if he was not involved.

100. It was suggested that to him that otherwise the fraudsters would not know who he was selling to. Mr Sanghrajka said "I do not know, I could not answer that because I mean it could be anything or anybody finding out information as to where I have actually sold the goods to in order to get [them] back".

101. It was then put to him this was information that you say you would not disclose. He replied "Yeah, but there were lots of people like the logistics company, the inspection company who had a knowledge of where the goods were going".

102.He agreed with the suggestion that "…it is possible that the logistics company and/or the inspection company were also involved in the fraud". He made no allegation to that effect and we make no finding on this matter. However, we do note the possibility that this could happen. There was no evidence before us that it did here.

103.When asked how payment would work Mr Sanghrajka said "I was exporting the goods, so once the customers were obviously satisfied that the goods had reached the destination that they have and they have checked the goods for what they were they would then make the payment. The only inherent risk that I saw in doing that transaction was that if in the event they did not take delivery of the goods or did not pay for it. I would have had recourse and send the goods back to me and my loss on that would just have been the freight element of and also storage in respect of the goods".

104.He agreed the phones that he was selling in the relevant deals were European specification phones (i.e. two pin plugs), and that he was exporting them in most cases, (7 of the 9 deals) and was exporting them to the EU. He also accepted that as between Privin and its immediate supplier the buying and selling happen very quickly.

105.He accepted that there could be a delay in payment.

Insurance

106.There was discussion between the parties at the hearing concerning the insurance position.

107.During the hearing a letter and some emails were produced by the Taxpayer and admitted in evidence without objection by HMRC.

108.The purpose of the letter was to provide cover for one specific consignment that needed to be insured as the yearly policy did not cover it. This was for the most expensive consignment.

109.The emails showed the Taxpayer asking for two freight forwarders to be added to the insurance policy. This was because after the Taxpayer had taken out the policy towards the end of May it was later realised that the two companies in question were not actually on the insurance company's list, so it was requested that they be added to the insurance policy. It was accepted that this was correcting an oversight.

110.A query was raised as to why £3,499.98 had been taken from Privin's account which was resolved satisfactorily by the emails.

111.Mr Sanghrajka accepted that the insurance that Privin had in place did not always cover the value of the consignment in question. Mr Sanghrajka said "It was a commercial decision not to insure the excess amount. Well, that was a commercial decision that I was entitled to make."

112.He continued "… also those were the standard policies that were available at that time. Once you have a trading record, the insurance company will then look at what was required on an average invoice sale. That's what I was informed by the insurance company after I had taken out this insurance".

113.We are satisfied that the insurance arrangements existed and were commercial. It was not shown that Privin arranged just enough insurance to make the deals look bona fide and we so find as a matter of fact.

Faulty Stock

114.Mr Sanghrajka said Privin were not concerned about stock being faulty because the end user would have a warranty with the manufacturer.

115.Mr Sanghrajka agreed that that takes care of the position where there is a retail sale to somebody who actually wants to use the phone. He said "That's the only time you find out that the phone is faulty".

116.As far as other wholesalers were concerned Privin would ship the goods out "on hold", and the wholesaler would do an inspection. There was thus no issue.

117.We accept this evidence.

Orchestrated Fraud

118.Counsel for the Respondents put it to Mr Sanghrajka that "the truth is that this was an orchestrated fraud and you were a part of it, were not you?"

119.He denied this. He did not agree. He rejected the suggestion "It could not have worked without your co-operation".

120. He did not agree that "At the very least, you shut your eyes to clear signs in your due diligence and in your trading partners' behaviour that this was a fraud".

121. We were not taken to any evidence which contradicted this. We agree with Mr Sanghrajka and so find as a matter of fact.

FCIB

122. FCIB was the bank that was used in the transactions in the chains.

123. We were provided with a translation of a Dutch press release of an emergency intervention by Dutch authorities into the FCIB bank. Officer Mandalia accepted that was "the first sign of any trouble with FCIB" that is October 2006 and so after the trades in question.

124. Officer Mandalia also accepted that:

124.1. FCIB offered, back in 2006, the real time transfer of money;

124.2. That enabled transactions to be done speedily; and

124.3. FCIB's charges to their customers were highly competitive with the British banks, who

were not offering a comparable service.

125. Ignoring hindsight it is hard to say that the involvement of FCIB meant that Privin was involved in fraud or should have known then that its transactions were connected to fraud.

Due Diligence

General

126.Much time was spent during the hearing on this aspect in the witness evidence. We bear in mind the warnings of the Court of Appeal to the Tribunal not to focus overly on due diligence but we set out the evidence led before us so far as is relevant.

127.Mr Sanghrajka said that the factors that might lead him not to deal with a particular company included:

128. delays in filling in Privin's application forms and in giving the information sought;

128.1. this would be particularly the case as far as personal information and directors information was concerned;

128.2. also refusal or delay in giving routine information needed to carry out due diligence; and

128.3. if on the Veracis report it indicated that they were not helpful in providing the information that was required for this and if they did not have enough due diligence checks that they were doing on whoever they were buying the goods from.

129.Mr Sanghrajka told us that in his experience the credit rating of companies was not of any importance at all where you are not extending credit. Further, "… if somebody did a credit check on my company [then] I would not have been able to trade at all and that's any new company". We accept this evidence.

Veracis

130.Privin had checks carried out on a number of companies they dealt with. The checks were mainly carried out by a company called Veracis Limited. Some other reports were also obtained.

131.Officer Mandalia agreed "… that, as a process, Veracis is a pretty thorough verification exercise" and generally, offers a considerable degree of detail. He answered "Yes" to the question "So the process Veracis follows, you would accept, is rigorous enough?"

132.He also agreed that the reports cover the topics that HMRC are anxious to advise traders about and set out what HMRC would like to see done.

133.He did not level any criticism against Veracis but he had adversely commented on some companies used to conduct some of these checks in his witness statement but this did not include Veracis.

134.He also accepted that the Veracis checks verify much of what the face-to-face visits recommended would be designed to verify.

135.He also accepted that "The process of gathering the information conducted by Veracis goes beyond … the guidance given by HMRC". An example of this was the Veracis report on SFMS which (inter alia) states that "… the VAT officer, as of April, is not aware of any outstanding issues with this company". It also said "robust due diligence procedures appear to be in place for suppliers and customers, and third-party payments are not made".

136.There were a considerable number of enclosures with the reports. The Officer accepted that they "…underline and demonstrate that the checks said to have been carried out have in fact been carried out" and that in the case of FMS this was carried out in advance of Privin trading with FMS.

137.Officer Mandalia accepted that within the robust process used by Veracis which listed negative factors, there were a number of positive factors that point towards it being a proper commercial decision to trade with a company. This was so for FMS and others.

138. The Officer accepted "that for trading of the nature that Privin was engaged in, a supplier's credit rating would not be the most important feature". Privin was not offering them credit terms. It was a background feature.

139.He agreed "Ultimately HMRC cannot in advance endorse a decision to make a trade…" and "So ultimately there is a commercial decision made by the trader as to whether to go ahead or not".

Due Diligence in respect of LBS

140.LBS was a non UK incorporated company that was not in the UK. Mr Sanghrajka did not visit LBS.

131.Mr Sanghrajka received LBS's introductory letter which said "a lot of good things about them which one would expect of an introductory letter". It named Exion Limited amongst others as a trade reference. Mr Sanghrajka said he did not do any sort of research (such as a Google search) into the names that LBS had provided as trade references.

132.Mr Sanghrajka told us that a "…a trade reference from any company would from my previous experience that I have had in other trades is just to find out whether the company is paying on time or if they have had any problems with it".

133.Mr Sanghrajka agreed that "…in principle somebody could put down, for example, a company that does not exist" as a trade referee.

134.Mr Sanghrajka validated the VAT number that LBS had given him through the Europa site. Mr Sanghrajka used Europa when he could not get a response from Redhill. Alternatively, he would phone and verify the VAT number through the helpline.

135.LBS also sent Privin their bank details. Mr Sanghrajka considered that "They were just bank details for us to have on file".

136.However the fact of the identity of the bank gave some comfort to Mr Sanghrajka as the Bank must have done due diligence checks on the company. When Mr Sanghrajka opened an account with the Bank his experience was it took almost a month and the due diligence checks they did were quite extensive.

137.A number of attempts to verify the VAT status of LBS were made. Mr Sanghrajka took a while to get a response from HMRC about LBS's VAT status and when it did come through it was not particularly positive.

138.Mr Sanghrajka said he made a commercial decision on this on the information he had at the time. We have no reason to doubt this and accept his evidence.

Due Diligence in respect of Compagnie

139.Compagnie introduced themselves to Privin through the web portal.

140.The evidence before us was that Compagnie came to visit Privin in the UK but exactly when was not clear. We have no reason to doubt this and accept his evidence. Mr Sanghrajka told us that "It was Mr Morgan who came over. He called me and said he happens to be in London and he would like to meet up".

141.Mr Sanghrajka when asked said he did not think there was anything odd about a UK national resident in the UK running a company in France as "… in this day and age people have companies all over the world based, it could be based anywhere and have companies anywhere in the world".

142.In their letter of introduction Compagnie say:

"Please note that we will only enter into trade relationships with clients who fully support our stringent policy of undertaking strong due diligence checks ..."

143.Compagnie offered two trade references. Mr Sanghrajka "… did not do any checks to see if these people existed or anything like that".

144.Mr Sanghrajka wrote to XM Global Markets and Digital Connect for references in respect of Compagnie.

145.XM Global Markets response confirmed that Compagnie has been a client of XM Global Markets since January 2006. They said:

"We have had a very good business relationship and have encountered no problems with the company since we started providing services to them. We have conducted our own due diligence".

146.Mr Sanghrajka accepted that he did not know what XM Global Markets did.

147.Privin commissioned a Dunn & Bradstreet report on Compagnie after Privin had done one deal with Compagnie.

148.The "D&B risk assessment" said the D&B rating is HH where HH represents a significant level of risk,

149.Mr Sanghrajka told us and we accept his evidence that this was an ongoing check on the company. It was not particularly related to the first due diligence checks. Privin also had a report from Veracis. D&B also said "According to our analysis of this company's legal information, this situation is below average. As long as no unfavourable information relating to payment behaviour is received, the influence on the risk indicator is neutral. The absence of required financial statements is influencing the risk indicator unfavourably. This is a young company. We have no record of delayed payments for this company."

150.Mr Sanghrajka told us he took a commercial view on this. We accept his evidence on this point.

Cell.Com.

151.Mr Sanghrajka was introduced to Cell.Com when he went to Dubai. One of his Kenyan friends was buying stock from them.

152.Mr Sanghrajka had their introductory letter and a copy of their commercial licence. Mr Sanghrajka received a report by D&B on them which did "… not really tell [him] very much".

153.Mr Sanghrajka looked for trade references in respect of Cell.Com himself while he was in Dubai by speaking to traders there. He spoke inter alia to Mr Sohill the owner of the company and a company called Smart Mobile.

154. Mr Sanghrajka was happy to do business with Cell.Com based on what he had in his due diligence and from what he had seen in Dubai.

FMS

155.This was a supplier to Privin. Mr Sanghrajka visited them.

156.FMS sent Privin a letter of introduction dated 11 April 2006.

157.Mr Sanghrajka sought confirmation of their VAT status by phone.

158.There was Veracis report on FMS (see above) in April 2006 and also a Global Asset Management Report where the "Quiscore" indicated caution and in the past has been caution, normal, stable, caution.

159.Trade references were taken up.

160.Mr Sanghrajka did not conduct checks to make sure that the referees existed.

WHY

161.Mr Sanghrajka personally visited WHY Systems premises to verify that they were trading. He also met "the chap who ran WHY" socially. Mr Sanghrajka met him once in his office and also when he came down to London socially at a restaurant.

162.There was a due diligence report on WHY from Veracis which said:

"The company is trading out of a small office above a video shop in a terraced property in the centre of Cowdenbeath. The accommodation is cramped and untidy" …"The freeholder and the video shop business are owned by William Young Senior. The utilities bills are all paid by the video business."

163.The Report says Veracis were not able to meet with Mr Redpath, the director. They conducted the interview with William Young, who had just resigned. The office manager had only been there for a number of weeks. It continued:

"Mr Young gave an undertaking that he would produce to us evidence of his ID and home address, but to date we have not received these documents."

164.This report was after the trade and it was a "follow up" as with other companies.

165.There was also a Credit Safe report that was obtained in May 2006.

166.Privin approached Trans Global Trade for a reference in respect of WHY Systems. In April 2006 Privin got a response saying that Trans Global had traded with the company for over five years and that

"The account is always paid strictly in accordance with payment terms. We have done regular business with this company over the years."

167.Mr Sanghrajka did not do any research into the existence of Trans Global Trade.

168.Although Privin requested a reference in April 2006, it was not received until May 2006.

169.Mr Sanghrajka accepted "that didn't stop you from trading with WHY in the meantime". This was because he was satisfied at the time by the checks that he had done personally, and made a commercial decision.

170.There was also a trade reference from an entity called Maximus.

New Ora

171.Mr Sanghrajka told us he visited New Ora at their premises to verify they were trading but he did not have a precise date as to when this visit took place.

172.The Veracis report in respect of New Ora was prepared in May 2006. This said inter alia: "The directors were not prepared to share any turnover or working capital figures with us. They did advise us, however, that turnover is now significant and that the negative worth shown in the filed accounts would be turned into a positive figure ..."

173.Mr Sanghrajka told us this was not a cause for concern "…because … Veracis could have gone to Companies House and got their figures".

Paper Trail Due Diligence?

174.It was suggested to Mr Sanghrajka that the reason that he undertook any due diligence was not because he was particularly interested in the answers but because he knew that Customs expected to see evidence of due diligence. Mr Sanghrajka did not agree with that and we accept his evidence.

175.He did not agree that "the truth is that you traded with these traders regardless of any negative indicators that were thrown up by the due diligence".

176.He did agree that the release to FMS was an oversight on his part that happened twice.

IMEI numbers

177.Privin retained records of the IMEI numbers that were scanned. Mr Sanghrajka personally did not ever conduct any checks in respect of those numbers. He told us that "… the inspection company must have checked whether I have dealt in those, I have traded those phones before or not, on my database they held". We have no reason to doubt this and accept this evidence.

Submissions of the Parties

The Taxpayer`s submissions in outline

General

178.In essence, the Taxpayer argued that:

178.1. The Taxpayer did not have actual knowledge of the fraud in the chains; and

178.2. There was nothing that showed it should or ought to have known that there was fraud in the chains.

178.3. Accordingly it was not the case that the only reasonable explanation for the Taxpayer's transactions was fraud.

Further Detail

179.In more detail Privin argued as follows.

180.The burden of proof was on HMRC. It was for HMRC to prove fraud and the Appellant's knowledge in its trading. This burden can only be discharged if fraud is the only reasonable explanation for the Taxpayer's trading.

181.Privin accepted that there is a substantial grey market in the wholesale distribution of mobile phones. It went on to caution that "In analysing whether the connection to fraud is the only reasonable explanation the Tribunal should guard against making any findings adverse to the Appellant that arise from factors that would be part of both legitimate trade on the grey market and fraudulent trading".

182.Privin argued that HMRC have misunderstood the commercial nature of the market.

183.The market, and the margins involved, dictate the way the transactions are conducted. This is commodities trading. That is trading that:

183.1. is in significant quantities,

183.2. produces substantial turnover; and

183.3. relies on fixed profit margins and speed of delivery.

184.It is rare that a trader in this market will ever retain any stock and it is rare that a trader will actually view the goods.

185.If there is legitimate trade in this market and that trade follows a similar pattern to its transactions which are challenged because they can be traced back to a defaulting trader, how can the Tribunal be satisfied that "the only reasonable explanation" for the circumstances in which the challenged transaction took place was that it was connected with fraud?

186.Given where the burden of proof lies, Privin submitted that the Respondents face a very substantial task in discharging their obligation to prove this case if those common factors are accepted.

187.The trading that Privin has engaged in was in line with the advice it was given by HMRC and at times exceeded those requirements.

188.Privin also contended that it is important to recognize that each individual piece of due diligence has a specific purpose. The officer's commentary on how the company has conducted itself often conflates the purpose of the various individual items as if each is relevant to every aspect of the process. It is in the nature of the actual commercial transaction being undertaken that the due diligence needs to be examined; it is submitted that the Appellant is correct in his statements when he identifies the purposes for which he relies on the various methods employed to check the probity of the transactions. The officer has failed properly to identify the issue that any individual piece of due diligence goes to and as such has confused himself and drawn averse conclusions on a false basis.

189.The market should not be seen as a sales market but as commodities trading; the purchaser has the option to buy the stock or not to buy the stock. It will not be an option, or very rarely, that the purchaser can buy a part of the stock.

190.The market must be seen in a proper global context. The grey markets in Western Europe and North America were substantial but the emerging markets in Asia, the Middle East and Eastern Europe/Russia were created as markets for the most popular phones due to delayed launch dates or inadequate stock which would drive prices in the local market upwards.

191.The evidence implicating the agents used by the Appellant in Holland and the UK (A1 Logistics) is not of itself proof of knowledge. They were widely used within the industry and any knowledge of their complicity is with the benefit of hindsight. HMRC had not by June 2006 ever warned anyone about using A1 Logistics nor had they ever been prosecuted.

192.It is noteworthy that although many traders in Operation Vex were prosecuted for the creation of false documentation necessary for the fraud, indeed all of the traders in Trial 2

faced that allegation, A1 logistics was not amongst them. The date of charge in Operation Vex of most of the traders was autumn 2009; it is a reasonable inference that at that time, A1 Logistics not being charged in Vex, HMRC did not feel confident of their case against A1 Logistics in the Criminal sphere. The information supplied by the Dutch authorities comes even later. We note that there was no evidence before us to support his information about Operation Vex etc. It was not objected to by HMRC.

193.It was further argued on Privin's behalf the above is illustrative of the danger of two things.

193.1. Knowledge gained via hindsight is not, by definition, obvious at the time.

193.2. A logical extension of the first is that the fact that a fraud occurred is not of itself evidence that the Appellant was complicit in it

194.If the evidence proves anything at all, it only proves a fact already admitted, namely that there was a fraud.

195.Privin stands by its evidence as to the adequacy of its procedures and of its rights to make his own commercial decisions. The Taxpayer rejects the suggestion that this was window dressing; he did the best he could in the circumstances to make sure that he was able to make an informed decision about the circumstances of his trading. Privin invested time and money into making these checks, the most expensive of which was above and beyond what was required, or suggested by HMRC.

196.Privin's director, Mr Sanghrajka, had extensive prior experience in import and export and spent a long time studying the mobile phone industry before he launched himself into it.

197.The funding of Privin cannot be said to be a cause for concern. The loan is in no sense tainted and thus so long as he was able to cover the repayments the funding is of no relevance to the decision that the Tribunal is required to make.

198.The Taxpayer submitted that there are reasonable alternative explanations for its trading. For example, Privin was an innocent trader caught in fraudulent chains.

199.The Taxpayer submitted that HMRC cannot prove and had not proved that the only reasonable explanation for Privin's transactions is that it knew that the deals it was doing were driven by fraud.

200. Accordingly, the Appeal should be allowed.

201. ***HMRC`s submissions in outline***

General

202.In essence HMRC argued that on the balance of probabilities the Appellant either:

202.1. knew ; or

202.2. should have known that it was participating in a fraud,

and that accordingly the appeal should be dismissed.

203. HMRC relied upon the law as set out in their opening submissions. HMRC submitted that although in *Mobilix* Moses LJ uses the phrase "only reasonable explanation is fraud" in discussing the Kittel test, the legal test remains that set out in *Kittel*, i.e. whether or not the Appellant knew or should have known of the fraud (see HMRC's closing submissions paragraph 2).

Further Detail

204. In particular, the following factors do demonstrate that Privin knew or should have known of the connection between its transactions and the fraudulent evasion of VAT.

(i) *Prior knowledge of MTIC fraud*

205.Mr Sanghrajka accepts that Privin was aware of the risks of MTIC fraud.

(ii) *Uneconomic supply chains*

206.In a competitive market a genuine wholesaler will seek to shorten the supply chain to maximize its own share of the available mark-up.

207.The chains seen in this scheme are too long to be commercially viable and any reasonably competent trader in Privin's position would have recognized this as an indicator that the transaction was fraudulent.

(i) *Participation in FCIB circular payment chains*

208.Privin's participation in the circular chains of payment cannot be coincidental. The members of such a scheme could not risk transferring any of the proceeds of the fraud to an innocent trader who might then unwittingly remove the money from the control of the scheme.

(ii) *Privin's role in the transactions*

209.Privin was the "broker" in the 9 deals. This role is of central importance in the overall fraudulent scheme. The evidence demonstrates that the transactions were contrived and tightly controlled: each member of the scheme, including Privin, must have known in advance who to purchase from, what to purchase and when, and who to sell to, what to sell and when, as well as how payments were to be made.

210.In addition, the broker's mark-up is generally the largest. The broker is therefore in control of the largest share of the profit from the fraudulent transactions. It is highly unlikely that knowing participants in an MTIC scheme would risk using an innocent party as a broker, since doing so would be unnecessary, and would expose them to the risk of losing control of the scheme and of the profits.

(iii) *Inexplicable increase in turnover*

211.Mr Mandalia's table in his witness statement shows that Privin enjoyed an astonishing increase in turnover in April 2006 and May 2006, with no substantial history of trading in mobile phones, little apparent commercial effort on its part.

(iv) *Repeated connection with fraud*

212.Every one of the transactions in issue in this appeal can be traced back to a tax loss. It is submitted that Privin could not have entered into so many fraudulent deals by accident. The only reasonable conclusion is that Privin was aware that the deals were fraudulent.

213.The fact that the transaction chains were contrived as part of an overall scheme to defraud the revenue leads to the irresistible inference that all of the participants in the chain were part of the plan and therefore had actual knowledge of their roles in it. As set out above, introducing an innocent trader into the transaction chain in any capacity (particularly to play the central role of broker), would be an unacceptable and wholly unnecessary risk for the rest of the participants.

(v) *Nature and adequacy of Privin's commercial checks*

214.The process of vetting customers was window dressing for the benefit of HMRC. Mr Sanghrajka claims that he visited his suppliers and customers to vet them but there is very little evidence of this.

215.Due diligence sometimes involved third party reporting but this was carried out retrospectively. For example, a report on Cell Dot Com was obtained in July 2006, but Privin had sold goods to this company in May 2006.

216.Privin ignored warning signs in its due diligence which indicated that particular companies carried higher than average risk, or that their maximum credit limits were too low for the transaction in question.

217.There is no evidence that any further enquiries were triggered by the due diligence, or that Privin was dissuaded from trading when negative issues were raised.

218.At best, Privin failed to carry out adequate commercial checks, and that, at worst, such checks as were undertaken were only done to give the impression that genuine commercial due diligence was being undertaken when it clearly was not.

(vi) *Insurance*

219.Privin's insurance policy cover was: "cover in respect of goods stored on the listed Freight Forwarder's warehouse premises on all risks of physical loss or damage".

220.Seven of the nine exports in issue were undertaken by a freight forwarder not listed on the policy. Privin claims that these were covered by a different policy to a maximum of £1.4 million at any one location. The insurance premium is based on carrying £10,000,000 and a maximum consignment value of £700,000, but four of the deals exceeded the cover value. HMRC requested evidence of cover for deals exceeding £700,000 and was informed that a commercial decision had been taken not to insure the excess. It is submitted that it would be very surprising if a company trading in a genuine market was prepared to expose itself to this

sort of risk. The only explanation for this can be that the transactions were not genuine and that Privin knew that it did not bear any genuine commercial risk.

(vii) *Funding*

221. Privin claims that it was funded by a loan from Silvertown Global. The size of the loan, and the terms upon which it was made, both give rise to suspicion about its legitimacy. No commercial lender, it is submitted – regardless of family ties or longstanding connections - would lend such a large amount of money to such a small and untried company with no track record, proper credit rating or assets of its own.

222. HMRC also argued that the terms upon which the loan is made are also peculiar: all that is required are quarterly interest payments. There is no indication as to when capital repayments are made or how the capital sum is ever to be repaid.

223. The loan is said to be repayable on demand, but apparently no such demand has been made despite the dramatic reduction in Privin's trading after May 2006. Furthermore, Mr Sanghrajka has not explained how Privin is able to meet the quarterly interest payments without trading.

Discussion

Introduction

224. We set out at the start of this Decision our view of the issue and some questions relevant to deciding the case.

225. As noted above the essential issue in this case is whether or not the input deduction was correctly denied.

226. This raised a number of questions including the following.

226.1. Did the Taxpayer know that the Taxpayer's transactions had been or would be connected to fraud? Was there actual knowledge of fraud on the Taxpayer's part?

226.2. Should the Taxpayer have known that the only reasonable explanation for the transaction in which the Taxpayer was involved was that the transaction was connected to fraud? (See *Mobilix* [59]). Was there imputed knowledge on the basis of *Mobilix*?

227. In *Mobilix Ltd v Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517, [2010] STC 1436 the Court of Appeal had to consider the proper interpretation and application of the ECJ's decision in *Kittel*. We respectfully concur and adopt this as the principal decision to guide us in reaching our decision.

228. Moses LJ, with whom Carnwath LJ (as he then was) and Sir John Chadwick agreed, considered the meaning of the words "should have known" .

229. It was said:

"[51.] Once it is appreciated how closely *Kittel* follows the approach the court had taken six months before in *Optigen*, it is not difficult to understand what is meant when it is said that a taxable person 'knew or should have known' that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT. In *Optigen* the Court ruled that despite the fact that another prior or subsequent transaction was vitiated by VAT fraud in the chain of supply, of which the impugned transaction formed part, the objective criteria, which determined the scope of VAT and of the right to deduct, were met. But they limited that principle to circumstances where the taxable person had 'no knowledge and no means of knowledge' (§ 55). The Court must have intended *Kittel* to be a development of the principle in *Optigen*. *Kittel* is the obverse of *Optigen*. The Court must have intended the phrase 'knew or should have known' which it employs in [59] and [61] in *Kittel* to have the same meaning as the phrase 'knowing or having any means of knowing' which it used in *Optigen* ([55]).

[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."

230.Moses LJ considered the extent of knowledge that was required at [53]-[60]. He held at [55] that it was not sufficient for HMRC to show that the trader should have known that he was running a risk that his purchase was connected with fraud. He considered:

"[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."

231.Although legal certainty is not an issue before use we record for the sake of completeness that Moses LJ held that his approach did not infringe the principle of legal certainty (see [61] ff).

232.The Court of Appeal considered the facts of the appeals before it at [67]-[80]. In relation to the appeal by Blue Sphere Global Ltd it held at [75]:

"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."

233.The Court held at [81] that the burden lay upon HMRC to prove the trader's state of knowledge.

234.Moses LJ went on at [82]:

"But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. As I indicated in relation to the BSG appeal, *Tribunals should not unduly focus on the question whether a trader has acted with due diligence.* Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focussing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in *Kittel*, namely, whether a trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was." [Emphasis supplied]

235.He continued at paragraph [84]:

"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 reach a large and predictable reward over a short space of time."

236.We note in particular from this that "***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***." (emphasis supplied, see Moses LJ with whom Carnwath LJ as he then was and Sir John Chadwick agreed as set out above)

237.We have used this as our starting point and guiding principle in deciding this case. However, in so doing we have not disregarded the other case law but have used it as a guide star in seeking to ask the right questions. We also note that we are not to focus unduly on the question of due diligence. We have attempted not to be fixated by due diligence but have tried to bear in mind reality and commerciality in particular in reaching conclusions bearing carefully in mind the guidance from the Court of Appeal.

238.We take from this that on the basis of *Mobilix* in the light of the relevant factual circumstances, the Tribunal must be satisfied on the basis of cogent evidence, that at the time Privin entered its deal it either knew that there was a connection between those transactions and the fraud or that the only reasonable explanation for the transactions in question was that they were connected with fraud. The threshold is a high one and deliberately set by the Court of Appeal, if input tax recovery is to be denied. The onus is on HMRC to prove this on the balance of probabilities.

Prior knowledge of MTIC fraud

239.It was common ground that the Taxpayer's officers were aware of the existence of MTIC and carousel frauds and their relevance to the VAT system. It was disputed that they knew or ought to have known of the connection to fraud in the circumstances under consideration here.

240.The evidence did not show that the Taxpayer's officers knew or ought to have known of the connection to fraud in the circumstances under consideration here.

241. We find this as a fact and to the extent we can as a primary fact.

242. We have carefully considered whether the evidence provided a foundation for us to draw the inference that that the Taxpayer's officers knew or ought to have known of the connection to fraud in the circumstances under consideration here. We consider that there is an insufficient basis on which we could found such an inference. Accordingly we make no such inference.

Uneconomic supply chains

243. The Taxpayer was only aware of its immediate counterparties. It did not know the length of the chains and there was no evidence before us to show that Privin did know the chains and their length rather than just their counter parties.

244.Accordingly we reject this argument as there is no evidence before us to substantiate it.

245.We accept Privin's argument that in this case HMRC have misunderstood the commercial nature of the market. The position may well be different in other cases.

246.Privin argued that:

246.1. the market, and the margins involved, dictate the way the transactions are conducted. This is commodities trading. That is trading which:

246.1.1. is in significant quantities,

246.1.2. produces substantial turnover; and

246.1.3. relies on fixed profit margins and speed of delivery.

246.2. It is rare that a trader in this market will ever retain any stock and it is rare that a trader will actually view the goods.

246.3. If there is legitimate trade in this market and that trade follows a similar pattern to its transactions which are challenged because they can be traced back to a defaulting trader, how can the Tribunal can be satisfied that "the only reasonable explanation" for the circumstances in which the challenged transaction took place was that it was connected with fraud?

247. In this particular case we agree with Privin's argument. This does mean that this is the case in other circumstances. Each case must be decided by reference to its own facts.

248.Here HMRC had not taken us to any evidence or laid sufficient foundation which would enable us to draw an inference, to reach a different conclusion.

Participation in FCIB circular payment chains

249.Again this is founded on knowledge of the whole chain. There was no evidence before us that Privin knew of this. Accordingly we reject this argument as there is no evidence before us to substantiate it.

250.The use of FCIB was not controversial at the particular time. It is only with the benefit of hindsight that it becomes an issue. It is to be noted that the difficulties with FCIB only became public after Privin's transactions had been completed. Privin cannot be treated as having knowledge of this at the relevant time unless there was evidence to show this was the case. There was no such evidence before us.

Privin's role in the transactions

251.Interesting as this argument is, there was no evidence before us to substantiate it.

Accordingly we reject this argument.

Inexplicable increase in turnover

252.HMRC argued Mr Mandalia's table in his witness statement shows that Privin enjoyed an astonishing increase in turnover in April 2006 and May 2006, with no substantial history of trading in mobile phones, little apparent commercial effort on its part.

253.The increase is not disputed. However, we are effectively being invited to infer this was because of fraud. There is no direct evidence before us that this was the case. There is insufficient evidence before us to give a foundation to infer that that was the case. We make no such inference. Fraud is not the only reasonable explanation for it and we so find.

254.As noted above Mr Sanghrajka said that he spent 18 months before he started trading in the mobile phone industry conducting research, developing contacts and conducting small deals. We accept this evidence.

255.This could be the explanation for the increase in turnover. There was evidence before us to show that it was not.

256.Mr Sanghrajka told us (and we accept) that the process of identifying "a grey market opportunity" started back in Kenya when Mr Sanghrajka saw there was a market to send phones out to Kenya. Privin was then set up to start trading in this sector. The research that was done including research into the possibility of getting the grey market supplies for this in the UK.

257.We were told the research involved speaking to people, looking at the relevant websites and getting information as far as pricing was concerned, how the trades would be done and what sort of logistics would be needed. Mr Sanghrajka said he understood the mobile phone business at that time to be a very fast moving industry. In summary he said he "… made all the contacts via the website and just built up from there". We have no reason to doubt this evidence which we accept and we so find.

258.Mr Sanghrajka looked at websites and got information about prices and he decided that he would use Privin to start trading in the wholesale mobile phone business. This was similar to what he had done earlier with other businesses when he started dealing in clothing He had "no idea who was dealing in clothing" so he "…had to just build up to the business from there". We have no reason not to accept this and so find.

259.We reject this argument as there was no evidence before us to stand it up or on which to found an inference.

Repeated connection with fraud

260.There was no evidence before us to show that Privin was aware of actual fraud or that fraud was only the only reasonable explanation for its transactions as we have already found.

Nature and adequacy of Privin's commercial checks

261.We remind ourselves that the Court of Appeal said that the Tribunal should not unduly focus on the question whether a trader has acted with due diligence.

262.We have set out our findings on due diligence above.

263.We agree with Privin's contentions on this aspect.

264.Privin contended that it is important to recognize that each individual piece of due diligence has a specific purpose. The HMRC officer's commentary on how the company has conducted itself often conflates the purpose of the various individual items as if each is relevant to every aspect of the process. It is in the nature of the actual commercial transaction being undertaken that the due diligence needs to be examined; it is submitted that the Appellant is correct in his statements when he identifies the purposes for which he relies on the various methods employed to check the probity of the transactions. The officer has failed properly to identify the issue that any individual piece of due diligence goes to and as such has confused himself and drawn averse conclusions on a false basis

265.The trading that Privin has engaged in was in line with the advice it was given by HMRC and at times exceeded those requirements.

266.Privin stands by its evidence as to the adequacy of its procedures and of its rights to make his own commercial decisions. The Taxpayer rejects the suggestion that this was window dressing; he did the best he could in the circumstances to make sure that he was able to make

an informed decision about the circumstances of his trading. Privin invested time and money into making these checks, the most expensive of which was above and beyond what was required, or suggested by HMRC.

267. Privin's director, Mr Sanghrajka, had extensive prior experience in import and export and spent a long time studying the mobile phone industry before he launched himself into it.

Insurance

268. There was no evidence before us that stands up the argument here or on which to found an inference.

269. Accordingly we reject this argument.

Funding

270. The Taxpayer submitted that the funding of Privin cannot be said to be a cause for concern. The loan is in no sense tainted and thus so long as he was able to cover the repayments the funding is of no relevance to the decision that the Tribunal is required to make. HMRC's contention was the contrary.

271. We accept have already accepted Mr Sanghrajka evidence on this matter [see [61] ff above].

272. We agree with Privin's submission particularly having regard to the cultural aspects.

273. We reject HMRC's argument that the terms on which the loan was made give rise to significant concerns about its legitimacy and what HMRC sought to build on it.

Outcome and Disposal

274. We have found that:

274.1. Privin had no actual knowledge of fraud at the time of its transactions in question; and

274.2. Connection with fraud was not the only reasonable explanation for Privin's transactions in question.

275. To the extent that we may have not made findings of fact to cover this completely we make the necessary findings of fact.

276. The findings in 274 are based on the evidence that was led before us which we have carefully considered both in itself and as to what inferences can properly be made from it.

277. Accordingly, we find that in this case HMRC has not discharged the burden of showing actual knowledge of fraud or that Privin should have known that fraud was the only reasonable explanation for Privin's transactions with the consequence that the appeal is allowed.

278. Privin's appeal is allowed.

279. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ADRIAN SHIPWRIGHT
TRIBUNAL JUDGE

RELEASE DATE: 3 March 2015