TC04307

Appeal number: TC/2009/15091

VAT – MTIC fraud – Transactions connected to a fraudulent tax loss – Whether appellant knew or should have known of connection – Yes – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

IMENEX UK LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS
MRS SONIA GABLE

Sitting in public at 45 Bedford Square, London WC1 on 6-10, 13-17, 20, 21, 23 and 24 October 2014 and at Victoria House, Bloomsbury Place, London WC1 on 30 January 2015

Nicholas Yeo, instructed by iTax UK Business Solutions Limited, for the Appellant

James Puzey and Joseph Millington, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by Imenex UK Limited ("Imenex") against the decision of HM Revenue and Customs ("HMRC"), contained in a letter dated 18 September 2009, to deny input tax of £359,452.80 it incurred in relation to 13 out of 14 transactions in its 03/03 VAT period. During this period it purchased computer processing units ("CPUs"). HMRC's primary case is that these transactions were connected to Missing Trader Intra-Community ("MTIC") fraud and that Imenex, through its director Mr Wayne Edwards, knew of that connection. Alternatively HMRC contend that Imenex should have known that these transactions were connected to MTIC fraud.

2. Given the frequency in which MTIC fraud and its jargon has been described by the courts and tribunals we do not consider it necessary for us to provide yet another description or explanation of it here but should a description of this type of fraud be required, reference could be made to that adopted by Roth J at [1] – [3] of *POWA (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC).

3. In this case the transactions are alleged to have involved "typical", "basic" or, to use the description of the Upper Tribunal in *HMRC v Fairford Group plc* [2014] UKUT 0239 (TCC), the "vanilla version" of MTIC fraud.

4. Nicholas Yeo appeared for Imenex and HMRC was represented by James Puzey and Joseph Millington. Although throughout this decision we have referred to the respondents as HMRC this should be read, where appropriate, as a reference to HM Customs and Excise.

Evidence

5. We were provided with witness statements of the following officers of HMRC:

(1) Jayne Meek in relation to Imenex;

(2) Paul Johnson in respect of Roble Comm Limited ("Roble");

(3) Karen McDonald in regard to TextXS Limited ("TextXS");

(4) Daniel Outram regarding The Callender Group Limited ("TCG");

(5) Laurence Smith in respect of Equimail Limited ("Equimail") and Aston Technology Partners Limited ("ATP");

(6) David Reynolds in relation to T&N Distribution Limited ("T&N");

(7) Umesh Mistry in respect of Tamsa Trading Limited ("Tamsa");

(8) Lesley Camm in respect of the analysis of data and movement of funds in various accounts held at the First Curacao International Bank ("FCIB");

(9) Peter Dean in respect of the collation and analysis of data relating to export and intra-EU removals of CPUs; and

(10) Roderick Stone in response to matters raised on behalf of Imenex by Angela Deane, a director of Forward Logistics Limited ("Forward").

6. Officers Jayne Meek, Umesh Mistry, David Reynolds, Laurence Smith, Karen McDonald and Lesley Camm gave oral evidence before us and were cross-examined by Mr Yeo.

7. In addition we also heard from Dr Kevin Findlay who was also cross-examined by Mr Yeo. Dr Findlay's witness statement was in the form of a report setting out the typical distribution channels for the electronic components market (the white market), explaining the reasons and a description of the legitimate electronic component distribution grey market and setting out the tests he would perform in considering whether a transaction falls within his understanding of the legitimate grey distribution market.

8. Witness statements were provided behalf of Imenex by its director Wayne Edwards, Jason Weeks the former director of Aston Technology Partners Limited ("ATP") a supplier of Imenex, Hugo Dasbach of Solid Storage Solutions ("Solid"), a customer of Imenex, Angela Deane of Forward and Keith Hobson of iTax UK LLP Imenex's current advisers and who had previously been employed by Halliwells LLP and Ernst & Young ("EY") when these had acted for Imenex. Whilst at EY Mr Hobson and colleagues had conducted a review into the trading of Imenex resulting in the EY Report which we consider in more detail below.

9. Mr Edwards, Mr Weeks, Mr Dasbach and Mr Hobson all gave oral evidence and were cross-examined by Mr Puzey.

10. Having read the witness statements, particularly those provided by HMRC Officers, it is apparent that in addition to the factual evidence of the witness concerned these also contain comments, opinions and submissions. In *Megantic Services Ltd v HMRC* [2013] UKFTT 492 the Tribunal (Judge Berner and Judge Walters QC), in relation to an application to exclude "opinion" evidence, observed at [15]:

> "… is not a matter of fact but a matter of opinion. It is merely a view of a witness on a matter on which the tribunal itself must reach its own conclusion, and as such is of no value as evidence. Such evidence may rightly be excluded on that basis. In most cases, however, we would not see it as necessary, or indeed proportionate, for a forensic exercise to be undertaken, either by the parties or by the tribunal, to identify any such matters in each witness statement and for the tribunal formally to direct that they be excluded. Generally speaking, we think that the parties can rely upon the good sense of the tribunal to disregard purported evidence that represents conclusions that the tribunal itself must reach. That can usually conveniently be the matter of submission at the substantive hearing, rather than a formal application to exclude."

The Tribunal also noted, at [20], that:

> "… we indicated to the parties that there were in the witness statements clear expressions of view on the conclusions that could be drawn from

> the analysis presented, and that such expressions of view, on matters which it is for the tribunal to determine, did not amount to evidence to which the tribunal would have regard. … the tribunal itself is quite capable of distinguishing between the evidence on which a conclusion falls to be drawn by the tribunal and an attempt by a witness to draw that conclusion themselves."

We have adopted such an approach in the present case in respect of the opinions, comments and submissions drawn by witnesses of fact.

Facts

Background

11. Imenex was incorporated on 5 March 1996. On 11 April 2006 D E Ball & Company Chartered Accountants, acting for Imenex, submitted an application for registration for VAT (form VAT1) for Imenex to HMRC. Its proposed business activity was the "import and distribution of IT equipment" with an anticipated turnover of £600,000. It did not expect to be entitled to regular VAT repayments.

12. Mr Edwards has been the director of Imenex since its incorporation and although David Edwards, his father, is the company secretary it is understood that he has not had any active involvement in the business. This involves trading in wholesale quantities of high value electronic goods including CPUs, a trade in which it has been concerned since its formation.

13. Imenex's turnover for the year ended 31 March each year was as follows:

31/03/1997 - £774,912

31/03/1998 - £2,150,069

31/03/1999 - £2,937,503

31/03/2000 - £2,266,824

31/03/2001 - £20,878,500

The increase in turnover in 2001 was the result of deals Imenex had undertaken with various companies between August and November 2000 which, in addition to its usual trade in CPUs, involved the purchase and sale of mobile telephones. However, Mr Edwards was unable to say what percentage of the trade related to mobile telephones and how much to CPUs.

14. On 19 April 2001 Mr Edwards was arrested and was subsequently prosecuted, with others at Birmingham Crown Court, for conspiracy to cheat the public revenue by way of a VAT MTIC fraud in which it was alleged that Imenex had acted as a buffer to facilitate a missing trader in deals involving mobile telephones. In his opening statement to the court prosecuting counsel described in detail how MTIC fraud operated. The case against Mr Edwards, according to that opening statement, was based on a document found on his computer belonging to an employee who denied the document was his. It was alleged that, despite his denial, as Mr Edwards also had access to the computer the document must be his.

15. After a trial lasting three months, on 19 December 2002, Mr Edwards was acquitted.

16. It was clear from his demeanour when asked about the trial in cross-examination in the present case that it had had a traumatic effect on Mr Edwards and he still found it upsetting to talk about. He described himself as a "bit shell shocked" when he had heard counsel's opening in the trial and the trial itself as "umpteen weeks of torture."

17. Following his acquittal Imenex ceased to trade in mobile phones. In evidence when asked about wanting an acknowledgement from HMRC that regarding his due diligence, Mr Edwards said:

> "I wanted to go back to what I had been doing with the CPUs but also, I guess – you know, I just wanted some form of – I don't know how to explain it, it's hard. It's just when you've been through that then you kind of start again and you go back to what you've been doing for years, in terms of the CPUs and stuff."

18. This clearly had an effect on the turnover which substantially reduced until the subsequent increase in 2006 leading to the deals in Imenex's 03/06 VAT accounting period, the period with which we are concerned, as can be seen below:

> 31/03/2002 - £8,497,207
>
> 31/03/2003 - £3,179,985
>
> 31/03/2004 - £523,072
>
> 31/03/2005 - £8,176,235
>
> 31/03/2006 - £21,806,114

19. Mr Edwards, who agreed that the industry in which Imenex operated was "subject to widespread fraud" but engaged in it because there was "genuine business there too", explained that there had been a substantial increase in turnover in 2006:

> "… because my clients bought more product from me because they had demands, they had bigger demands."

03/06 VAT Return

20. On 11 April 2006 Imenex submitted its 03/06 VAT Return to HMRC. this declared a turnover for the month of £2,162,660, no output tax and a repayment claim for £359,905.13. During this period Imenex had entered into 14 deals of which 13 involved the purchase and sale of CPUs. As a result of the repayment claim the Return was selected for extended verification and other than deal 12 (which is not set out below as it does not form part of the appeal) the transactions were traced back to a tax loss. Input tax was therefore denied by HMRC on the basis that Imenex knew or should have known of the connection to fraud in each of the deals which we set out in further detail below.

Deal 1

21. On 7 March 2006 Imenex purchased 1,000 Intel SL7Z9-Retail CPUs from Tamsa which it sold to Solid in the Netherlands.

22. Tamsa had been supplied by Culmain Limited ("Culmain") which had acquired the goods from Emmen Limited ("Emmen"). Emmen's supplied was Globetec UK Limited ("Globetec") which had been supplied by TCG. It is not disputed that TCG was a fraudulent defaulting trader.

23. The goods were shipped on 7 March 2006 and Imenex paid its supplier Tamsa on 8 March 2006 through its HSBC account. Imenex received payment into its HSBC US dollar account from its customer, Solid, on 10 March 2006 transferring the sum to its HSBC sterling account on 16 March 2006 eight days after it had paid for the goods.

24. Unlike most participants in this and subsequent deals, Imenex, which had a sterling and US dollar accounts with HSBC, did not use an FCIB account and neither did its immediate counterparties in this and subsequent deals eg. In addition to its FCIB account Tamsa also banked with Credit Suisse.

Deal 2

25. On 8 March 2006 Imenex purchased 1,000 Intel SL7Z9-Retail CPUs from T&N which were sold to Solid.

26. T&N acquired the CPUs from Manhattan Limited which itself had been supplied by Emmen. Emmen's supplier was the Optimal Group Limited and it had been supplied by MG Comp which had been supplied by TCG.

27. T&N operated from the home, on a council estate, of its director Neil Kaye for whom it was a part time venture to supplement his main employment putting up posters on the London Underground.

28. Imenex paid T&N for the CPUs on 8 March 2006, the day of shipment, but was not paid by Solid, its customer, until 10 March. As in Deal 1 payment was made into the HSBC dollar account and transferred to Imenex's sterling account eight days later on 16 March 2006.

Deal 3

29. On 9 March 2006 Imenex sold 1,575 Intel SL&Z9-OEM CPUs to ASAP Trading GmbH ("ASAP") in Austria which it had acquired from ATP.

30. ATP had been supplied with the CPUs by Culmain which had been supplied by Proforce Limited ("Proforce") which had acquired the goods from Connect Limited ("Connect"). TCG had supplied Connect

31. Imenex received payment for the goods from ASAP on 9 March 2006, the date of shipment but did not pay ATP until 13 March 2006.

Deal 4

32. Also on 9 March 2006 Imenex sold ASAP 2,205 Intel SL&Z9 CPUs having been supplied by ATP.

33. ATP's supplier had been Culmain and the deal chain has been traced back to TCG via Emmen and Globetec.

34. Analysis of the bank accounts of the participants, primarily those holding FCIB accounts, in this deal by Officer Lesley Camm indicate that there was a circularity of funds. Payment to Imenex for the goods by ASAP and payment by Imenex to ATP were both made on 9 March 2006, the date of the transaction.

Deal 5

35. In addition, on 9 March 2006, Imenex sold ASAP 2,520 CPU-P4 3.0 gzhhs which it had purchased from ATP. As in Deal 4, above, the supply chain can be traced from ATP to TCG via Culmain, Emmen and Globetec.

36. Imenex received payment from ASAP and paid ATP for the goods on 9 March 2006. Analysis of the bank accounts of the participants in this deal, particularly those with FCIB accounts, indicates a circularity of funds.

Deal 6

37. On 13 March 2006 Imenex sold 1,400 Intel SL7Z9-Retail CPUs to Solid that it had acquired from Tamsa.

38. Tamsa had acquired the CPUs from Culmain which had, in turn, been supplied by Futuristic Limited ("Futuristic"). Futuristic's supplier was Connect which had been supplied by TCG.

39. Although Imenex paid its supplier Tamsa for the CPUs on 13 March 2006 it did not receive payment from Solid until 16 March 2006 when funds were paid into its HSBC dollar account. These funds were transferred into Imenex's HSBC sterling account on 20 March 2006, seven days after the transaction had taken place.

Deal 7

40. On 14 March 2006 Imenex acquired 3,000 Intel SLZ9-CPUs from Tamsa which it sold to ASAP.

41. The CPUs had been supplied to Tamsa by Culmain which had been supplied by Proforce which had been supplied by Connect which had acquired the goods from TCG.

42. Imenex paid Tamsa on 15 March 2006 but received payments on 20, 21 and 27 March 2006 from ASAP. An analysis of the bank accounts of the participants indicates that there was a circularity of funds in respect of this deal.

Deal 8

43. On 16 March Imenex sold Solid 1,000 Intel SL7Z8-Retail CPUs which it had acquired from Tamsa.

44. As in Deal 6, above the deal chain can be traced from Tamsa through to TCG via Culmain, Futuristic and Connect.

45. Although Imenex paid for the goods on 17 March 2006 it was not paid until 21 March 2006 when a payment was made into its dollar account. This was subsequently transferred to its sterling account on 23 March 2006.

Deal 9

46. On 20 March 2006 Imenex sold 3,150 Intel SL&Z9-OEM CPUs to Swiss trader Bergmann Associates ("Bergmann") which it had acquired from ATP although Imenex had originally sought the goods from T&N. The deal log notes:

> "T&N let me down on Friday. Don [Balfry – director of Bergmann] went mad on Monday morning".

47. In this and Deal 10, below, ATP was supplied with the CPUs by TextXS. It is accepted that TextXS, which operated from "Gatsby's" a wine bar in Newcastle under Lyme, is a defaulting trader. When asked if Imenex would have dealt directly with TextXS, Mr Edwards said that he would have undertaken due diligence and "if they were operating from a wine bar" and "if that was the sole place of business" he would not have dealt with them.

48. Imenex was paid in respect of Deal 9 on 17 March 2006, three days before it paid its supplier on 21 March 2006.

Deal 10

49. A further sale of 3,150 Intel SL&Z9-OEMs was made by Imenex to Bergmann on 20 March 2006. Payment was received and made by Imenex from its customer and to its supplier on 20 March 2006.

Deal 11

50. On 21 March 2006 Imenex acquired 1,575 Intel SL&Z9-OEMs from Tamsa which it sold to Solid.

51. Tamsa had obtained the CPUs from Culmain which had been supplied by Maximise Limited. Maximise Limited had purchased the goods from Connect whose supplier was Innovate Limited which had been supplied by Roble Comm Limited. It is not disputed that Roble Comm is a fraudulent defaulting trader.

52. Payment for the goods was made by Imenex on 23 March 2006 although it received payment into its HSBC dollar account on 27 March 2006 and had not transferred this sum into its sterling account as at 7 April 2006.

Deal 13

53. Imenex ordered 2,000 Intel SL7Z8-Retail CPUs from ATP to sell 1,000 to Solid and 1,000 to ASAP. However, it was only able to obtain lesser quantities and on 27 March released 1,000 to Solid.

54. The deal chain in this deal and Deal 14, below, are identical. In both ATP acquired the CPUs from Maystar Limited which was supplied by Equimail Limited which it is accepted is a fraudulent defaulting trader.

55. Imenex received payment into its HSBC dollar account on 31 March 2006 although it had paid its supplier on 22 March 2006.

Deal 14

56. This deal comprises of the 550 Intel SL7Z8-Retail CPUs released to ASAP of the number obtained in Deal 13, above. Although Imenex paid for the goods on 27 March 2006 it did not receive payment until after 31 March 2006.

Contact with HMRC

57. The first VAT assurance visit by HMRC to Imenex took place on 12 June 1996 with a further visit on 23 May 2000. On 26 July 2000 Imenex requested it be permitted to make monthly VAT returns "due to plans to increase exports" having been advised by its accountants "because of the effect on cashflow." The request was granted by HMRC and from September 2000 Imenex has submitted monthly VAT returns.

58. On 18 November 2003 HMRC wrote to Imenex requesting information in relation to its business. Frisby & Co, solicitors for Imenex, replied on 20 November asking why this information was required as, having been acquitted their client was "naturally wary of submitting such information without greater particularity as to the purposes for which it is presently sought."

59. In their letter, of 9 December 2003, HMRC explained that this was a new initiative covering businesses in specific trade sectors of which Imenex's was one. The letter continued stating that HMRC were "continuing to experience a number of problems" with MTIC fraud in the wholesaling high technology trade sectors such as that in which Imenex was involved. A letter of 18 March 2004 from HMRC to Imenex advised that "due to a restructuring" verification of the VAT status of new customers and suppliers should be made through their Redhill office rather than the local VAT office.

60. In a further letter to Imenex from HMRC, dated 7 June 2004, it was stated that:

> Missing Trader Intra-Community (MTIC) VAT fraud constitutes one of the most costly current forms of VAT fraud within the EU. It is a serious problem for the UK and is Customs' top VAT fraud priority …

> Amongst the commodities regularly involved are computer chips and mobile phones and the VAT loss from this type of fraud in the UK alone is between £1.7 and £2.6 billion per anum.

The letter continued explaining that HMRC were experiencing problems in Imenex's trade sector and that it should, from 4 August 2003, verify the VAT status of new or potential Customers/Suppliers with HMRC's Redhill office and provide the following information:

> (1) The name of the new or potential Customer/Supplier.
>
> (2) Their VAT registration number.
>
> (3) Their contact numbers (including telephone number, fax number, e-mail address and mobile numbers if known).
>
> (4) The Directors and/or responsible members.
>
> (5) Whether they were buying or selling goods.
>
> (6) The nature of the goods.
>
> (7) The quantities of the goods.
>
> (8) The value of the goods.
>
> (9) Their bank sort code and account number.
>
> (10) A request to forward, on a monthly basis, a purchase and sales list with identifying VAT Registration Numbers against the suppliers/customers, to the Redhill VAT office.

61. On 30 June 2004 D E Ball, the accountants then acting for Imenex, wrote to HMRC as follows:

> When you were recently doing your review of the company, I mentioned that it was my client's intention to arrange for an officer of Customs and Excise to visit his trading premises and review his procedures and records in connection with goods being exported from the UK.
>
> Our client has since received correspondence from your Business Education and support Compliance Management Team stating that it is their intention to provide such support. When we contacted this management team, they informed us that the local office that would deal with our client is the Shrewsbury office.
>
> We would be grateful if such a visit could be arranged as soon as possible as our client has recently started trading again and has made a number of sales to Europe. He has used paperwork in connection with these transactions which we would be grateful for your review of and observations as to whether the paperwork is satisfactory and whether any further paperwork, procedures or amendments to the existing paperwork is necessary to meet all the requirements that HM Customs and Excise require of our client in connection with these transactions in Europe.

> To enable you to have an advance review of the paperwork our client is using, we enclose copies of the four forms that he is using and would be grateful for your observations on these on the day of your visit to our client's premises.

62. The forms referred to in the letter are:

> (1) a "Customer VAT/Trading Status Form" addressed to HMRC requesting verification of a potential trading partner "so we can be sure that the company is bona fide";
>
> (2) a "Supplier Confirmation of Due Diligence" which requests confirmation from a supplier that it is "valid for VAT" that the goods "are of legitimate quality" and that it has "clear title" of the goods and that the supplier's supplier is also VAT registered. The form also seeks confirmation that the supplier is "confident and comfortable" with its supplier's "due diligence procedures, and their ability to check their supply chain";
>
> (3) "Handling Instructions" which refers to the description and quantity of the stock and who is liable for its insurance; and
>
> (4) a "Supplier VAT/Trading Status Form" which is sent to HMRC to advise that Imenex is to purchase the stock specified in the form with a view to selling it in the open market. The form states that if HMRC wish to inspect the stock "we would very much appreciate it if you would refrain from damaging the presentation of the box by defacing manufacturers packaging with your identification stamps."

63. When asked about the fourth form and why Imenex did not want HMRC to mark boxes with identification stamps Mr Edwards, who said that he "never had an issue with Customs ever inspecting our stock", was unable to explain why such a request was made other than to refer to possible damage to labels.

64. The visit requested in the letter of 30 June 2004 took place on 3 August 2004 when Imenex was visited by Officers David Bayliss and Richard Horne. The visit report records that Mr Edwards "fully intends to trade as a broker" and that he "was refused a written acknowledgement that he was making satisfactory checks to meet C&E requirements but has been issued with Public Notice 726."

65. The report concludes:

> Trader has made it clear that he fully intends to trade in CPUs (though definitely not mobile phones) and expects to be a regular repayment trader with claims in excess of £1,000,000.00 a month envisaged within next 12 months. It is apparent that he carrys (sic) out sufficient checks to meet C&E guidelines and would be able to put up a very good case should he be challenged by ourselves in the event of a possible J&S/NEA action. He is sending in monthly dealsheets and in regular contact with Redhill.

66. Although the title of Public Notice 726 is "Joint and Several Liability" it is made clear (at section 1.3) that it should be read by all VAT registered businesses that trade in goods or services that are subject to MTIC fraud. This includes computers and any other equipment including parts, accessories and software made or adapted for use in connection with computers or computer systems (section 1.4). Section 4.4 of the Notice asks "How can I avoid being caught up in MTIC fraud?" It is answered in section 4.5 which advises that "reasonable steps" are taken to "establish the legitimacy of your supply chain and avoid being caught up in a supply chain where VAT would go unpaid." It continues:

> We [HMRC] do not expect you to go beyond what is reasonable. You are not necessarily expected to know your supplier's supplier or the full range of selling prices throughout the supply chain. However, we would expect you to make a judgement on the integrity of your supply chain.

Examples of checks are contained at section 8 of the Notice. However, section 4.6 makes it abundantly clear that these are "guidelines" only, as "a definitive checklist would merely enable fraudsters to ensure that they can satisfy such a list."

67. A letter sent to Mr Bayliss by D E Ball on 14 October 2004 concludes:

> … while you stated at the meeting on 3 August 2004 that you cannot offer any guarantees regarding the paperwork the company is using in connection with imports and exports, is there anything further that the company can be reasonably be expected to do over and above what they are doing at present?

68. Following a further visit by Mr Bayliss on 4 November 2004 to carry out a verification of Imenex's September VAT Return and a letter of 18 November 2004 from D E Ball, Mr Bayliss replied to the letter of 14 October 2004 on 29 November 2004. In that letter Mr Bayliss refers to the two visits he had made to Imenex stating:

> On both occasions it has been evident that Mr Edwards is making every effort to illustrate due diligence when dealing with his suppliers and customers. He verifies numbers through our Redhill Office and works along the guidelines covered in Public Notice 726, a copy of which was issued to Mr Edwards on 3 August.
>
> To this date the content of the paperwork seen as being used by Imenex has not been subject to change by Customs and Excise and he has not been instructed to make any amendments.
>
> You should be aware that there are no set checks that have to be undertaken to help avoid dealing with a high risk business, Public Notice 726 gives guidelines but not a definitive check list.
>
> For suggestions of additional checks that should be made by Imenex, I cannot make any such recommendations however, as I have explained to Mr Edwards, any additional check that clearly illustrates his due diligence would be taken into consideration should any transactions be brought into question.

69. Mr Bayliss visited Imenex again on 19 and 20 January 2006. His note of the visits recorded:

> Trader is normally reliant and carries out excellent Due Diligence, I am happy to accept all explanations for this repayment and to release on a without Prejudice basis, however, having spoken to him, I will consider a visit next month as trade is anticipated to be as previous months.

Due diligence

70. Mr Edwards explained that Imenex dealt with only a limited number of suppliers and purchasers where it knew the businesses and the personalities behind the companies well. He said that he had conducted due diligence on suppliers and kept detailed records and would only trade if he "felt comfortable" doing so. Verification of VAT numbers was also made with HMRC's Redhill office and the Europa website and required the documentation, described above in relation to due diligence, of which copies were sent to HMRC on 30 June 2004, to be completed by its counterparties.

71. In addition following a public presentation by EY, which Mr Edwards attended with Jason Weeks then of ATP, Imenex instructed EY to "conduct a compliance review in relation to its exposure to VAT risk".

72. The tone of the EY Report, dated June 2005, is apparent from its "Introduction" which states:

> The main risk to legitimate business in this market arises from unwittingly sourcing goods from suppliers in the supply chain who then fail to account for VAT or, conversely, from selling goods to customers who may, in their own way contribute to an onward failure to properly account for VAT. … Customs are now focussing their attention on the legitimate business in the supply chain, which often has been unwittingly caught up in the fraud and are now assessing such traders for consequent VAT loss rather than chasing the fraudulent operators.
>
> …
>
> The fraud which is the subject of the current Customs initiative itself is known as 'carousel' or MTIC (Missing Trader Intra-Community) fraud and is a major problem. It currently costs the Treasury £1.7 billion in lost VAT according to recent estimates, and Customs are under considerable political pressure to crack down on the fraud. Clearly this pressure had driven them to act in ways that some would say penalizes the easy target ie – the genuine trader. In any other business sector Customs first priority would ordinarily be the investigation and prosecution of the fraudsters but Customs are increasingly disallowing VAT recovery or assessing legitimate traders in order to stem the flow of VAT loss in preference to in-depth criminal investigations.
>
> …

> At the time of writing there is a great deal of uncertainty in the trading sector due to the aggressive tactics being employed by Customs and the lack of consistency in their application. The methodology applied by Customs has lead (sic) to significant damage and loss for many legitimate companies. Imenex have therefore considered it good business sense to conduct a compliance review in order to: -
>
> - Conduct an independent review of VAT systems;
> - Examine key legal developments (eg Bond House);
> - Review take on procedure for suppliers and clients;
> - Examine areas of current and historic risk;
> - Identify areas where additional safeguards are needed; and
> - Ensure that Imenex's relationship with Customs is business-like and professional
>
> The review which EY has conducted examines in detail Imenex's procedures and the legal developments that affect day-to-day business operations. The meeting notes and details of field-work undertaken at Imenex's premises and elsewhere can be found in the Appendices to this report. It is important to note that our profile of suppliers and customers was conducted on a sampling basis using risk-based methodologies. Our opinions are based on the sampling based audit of the supply chain and interviews with Imenex suppliers and customer personnel and not 100% verification of all transactions undertaken.

73. The "Executive Summary" of the EY Report noted that:

> Customs does not produce explicit guidelines on what "reasonable commercial checks" for due diligence are. However, at the commencement of our review in our opinion the level of due diligence performed by Imenex would have appeared to have met the requirements of Customs.
>
> The EY review enhanced the basic due diligence performed by Imenex through: -
>
> - Reviewing key suppliers such as Pars, Tamsa, IT Wholesale, Aston Technology and XEL Trading
> - Reviewing freight forwarders such as All-Ways Logistics and L&A Freight
> - Reviewing key customers such as Solid Storage Solutions in Holland
>
> EY has risk rated the supply chain into low, medium and high risk, and Imenex now has a tried and trusted methodology on which to base its business decisions. It is the view of EY that Imenex's due diligence procedures now exceed the requirements of the Finance Act 2003 "Joint and Several" Liability provisions. Furthermore Imenex is committed to conducting a rolling programme of due diligence to ensure it is constantly updated. It is our view that the steps Imenex has taken places it at the fore-front of compliance.

74. In its "Conclusions/Recommendations" section the Report states

> The current position regarding trade in this sector is that it still carries a high level or risk of exposure to VAT fraud. That said, our view is that the current level of due diligence applied by Imenex meets best practice in the sector.

After setting out the current risk management process the review:

> … concludes that this process was robust and actually led to a significant amount of business being rejected, although we recommend that Mr Edwards is to document more clearly the precise reasons why the business was actually rejected. Clearly even Customs would see this as a positive measure and recognise that there was a robust risk management procedure in place. Additionally, our experience in this sector suggests that the limited number of suppliers and customers coupled with the fact that Imenex's supplier and customer rejection rate is much higher than average means that Imenex is among the more responsible operators in this sector.
>
> If due diligence procedures are carried out both on the suppliers/customers the commercial viability of each deal and an audit trail is maintained detailing this, then our view is that Imenex is being more than "reasonable" in its commercial checks regarding "joint and several liability" when viewed against Customs guidelines issued following the Finance Act 2003. Unfortunately Customs will not produce explicit guidelines on what precisely constitutes "reasonable checks" however our view is that Imenex's procedures are at the upper end in terms of quality and overall risk management. If Imenex rigidly adheres to these procedures then any risk of dispute with Customs should be minimised and the Company would have robust procedures in place which, in our opinion, would certainly meet or exceed the requirements of the tax authorities in the UK and across the EU.
>
> In the event of any assessment for VAT being raised against Imenex by Customs the enhanced due diligence which is set out in this report would undoubtedly form the basis of a robust defence.

75. Following the reviews of the "key" suppliers and customers of Imenex undertaken by EY (referred to above) XEL Trading Limited ("XEL"), LA Freight, Solid, Tamsa and ATP were considered to be "low risk" by EY. However, Pars Technology Limited ("Pars") and All-Ways Logistics Limited ("All-ways") were regarded by EY as being "low to medium risk".

76. In relation to Pars the EY Report included the following observation:

> During a meeting with Pars Ernst & Young were told that there had been no occasion when a second purchase of a box of chips has taken place. A subsequent visit to XEL Trading appeared to contradict this view."

On being asked whether he was worried that Pars held dealt with the same box twice Mr Edwards said that although he had read the Report he had not seen that this had occurred. The visit report on Pars concludes:

> If Pars had shown us details of suppliers/customers and were conducting site visits they would have been rated low risk. However, they have a low/medium rating which can be improved upon if processes improve.

However, Mr Edwards was unable to say whether there had been any improvement as he had not made further enquiries to ascertain whether or not this had taken place.

77. With regard to All-Ways the EY visit report recorded that it was considered to be low/medium, risk due to matters which need to be addressed around document control which is further outlined in the site visit report. The site visit report notes that All-Ways requests and receives a Certificate of Incorporation and VAT Registration Certificate from all new clients and that these are sent to HMRC at Redhill for verification. The visit report continues:

> There is no current tracking system in place to avoid the handling of duplicated boxes, although All-Ways provide the box numbers to the clients they serve that request this information. EY were told that their clients did not always request this service. There was also some concern that such a process might bind All-Ways into any fraudulent supply chain for the purposes of joint and several liability notices as there is means of identifying duplication.

78. The visit report also provides details of the Imenex supply chain as follows:

> Ervatair deliver 9 boxes to All-Ways via FedEx. These boxes are then released to VenyPeco Consulting who release 9 boxes to ManU, who release 9 boxes to Proforce, who release 9 boxes to Squirrell, who release 9 boxes to KJM, who release 9 boxes to LTL, who release 9 boxes to Multisystems, who release 2 boxes to ATP, who release 2 boxes to Imenex who export them.

79. When asked about the EY visit report on All-Ways, in particular that All-Ways were concerned that if there was a tracking process in place to avoid handling duplicated boxes it might bind them into the fraudulent supply chain Mr Edwards said that:

> "It's their business, I can't run their business"

And, when asked whether it was something he did not really think about, Mr Edwards went on to say:

> "You know my main concern was that they handled my product and looked after my stock, checked it and packed it and handled it correctly"

In relation to the lack of any commercial purpose for a party appearing in such a supply chain as identified in the visit report Mr Edwards said that he did not know his transactions were connected to fraud although he accepted that from what he now knew the information in the visit report was a warning sign of fraud.

80. Although Tamsa were regarded as "low risk" by EY the visit report recorded that it was run by a husband, wife and son and had been in operation for four years having

originally sold garments before switching to electronics. It traded from serviced offices but was re-locating to the director's residential address. Its turnover at the time of the visit was "just under £50m per year".

81. Returning to the EY Report itself, having stated its conclusions it went on to recommend that in order to further reduce risk from suppliers and customers:

> … that going forward Imenex considers:
>
> - Enhanced checks are done on the approved suppliers and customers such as identification checks of the underlying owners so that the directors or shareholders personal and corporate history is analysed to ascertain whether any issues of concern arise;
> - Profiling should be carried out on selected overseas customers to the same standard as that applied to UK based suppliers and customers;
> - Imenex maintains a record of all CPU box numbers purchased and sold and furthermore show these on its invoices;
> - Imenex should ensure All-Ways enhances its operational procedures when handling stock;
> - The position regarding insurance of CPUs at All-Ways and in transit for export be fully clarified;
> - Due diligence is undertaken and updated on a rolling basis and a permanent record maintained;
> - Implementing a Due Diligence manual to demonstrate the process employed by Imenex;
> - Implementing a more focused, professional liaison with Customs through the periodic intervention of Ernst & Young by separate agreement;
> - Insisting that All-Ways conduct a full inspection of stocks and scan/photograph items on each deal; and
> - Going forward we advise that Imenex should request sight of the last 6 months VAT returns of his potential supplier before taking on any new business.
>
> Through a range of background checks carried out as detailed below the results of any profiling in the supply chain should be analysed and risk rated into red, amber and green categories using a well recognised risk management methodology. In essence, this means: -
>
> - Red Information strongly suggest that there are known risks (eg disputes with Customs) therefore high risk.
> - Amber Information suggests that there may be some doubts over integrity of processes and further work may be required to establish whether they are moved into red or green categories, thus medium risk.

- Green Nothing adverse identified, assessed as low risk.

Clearly, the red and green categories are easy to deal with, ie accept or reject. The amber group may present more of a difficulty as further work may need to be done in order to verify the accuracy of any adverse reports if a trading relationship were deemed to be particularly attractive. If additional profiling were done, it may be possible to move the prospective supplier or customer from amber into a green category.

The following background enquiries should be carried out periodically and independently reviewed:

- Site visits to suppliers, customers and logistics with a permanent record kept on file;
- Commercial viability checks such as Dun and Bradsheet and Companies House reports. Equivalent reports for overseas jurisdictions;
- Research on whether Directors/businesses have previously been bankrupt, have outstanding court proceedings, or are involved in litigation; and
- Registration with specialist internet sites such as "Factiva Fraud News" or "Lexis Nexis" to highlight information from media sources on potential fraud.

Once this information has been analysed a risk-rating can be given. Where a new supplier or customer fell within the green category and a commercial relationship was to be proceeded with then an additional record should be maintained detailing the commercial viability of the deal. The following procedure should be conducted:-

- A request is received from a customer for goods. Confirm the market price for that product and agree the price to be paid;
- Source the product from a supplier and agree the price. Compare the market rate for goods and calculate profit margin;
- If all these requirements are met, proceed with the deal, creating a permanent record of the calculations carried out.

This procedure then complies with both aspects of due diligence, that undertaken on the actual client and that on the actual deal itself. If the 'traffic light' system is adopted, Customs can clearly see that Imenex is taking due diligence very seriously and has adopted a widely accepted methodology for doing so. If Ernst & Young's recommendations are accepted, notwithstanding the high level of risk inherent in this sector, we believe that Imenex will have reduced its level of operational risk to an absolute minimum. In the unlikely event of a dispute with Customs, Imenex will have good grounds for a robust defence and should be in a good position to challenge any withheld VAT repayments. Furthermore we fully endorse the strategy of enhanced due diligence on a limited supplier/customer base but significantly increasing the volume of transactions.

82. In evidence, Mr Hobson (who had been involved in the compilation of the EY Report) said that EY's view at the time the Report was written was that:

> "… by doing what Imenex engaged us to [it] was managing [its] risk against unwittingly [being] caught up in a supply chain where fraud could be found."

He confirmed that in compiling the Report EY were:

> "… looking at his [Mr Edwards/Imenex's] internal document control and the due diligence that he was at the time conducting. And then, when we conducted a review of his suppliers and customers, we [EY] obviously came back with recommendations."

83. Imenex clearly places considerable reliance on the EY Report. Mr Edwards explained that EY had a "…sizable department that specialised in this [assessment of due diligence]" and that he had paid EY "as professionals and specialists" and was "led by these people".

84. However, despite this Imenex did not implement the recommendations advised by EY in the Report. It did not ascertain other directorships held by suppliers or maintain records of retail stock purchased. Neither did it ensure All-Ways enhanced its operational procedures when handling stock, clarify the insurance position of CPUs held there or insist that All-Ways conducted a full inspection of stocks and scan/photograph items on each deal. Also contrary to the recommendations in the EY Report Imenex did not undertake and update due diligence on a rolling basis or maintain a permanent record and it did not request the VAT returns of potential new suppliers.

Grey market

85. Mr Edwards described Imenex as trading in the legitimate grey market for Information technology components and related products.

86. Dr Findlay whose evidence concerned the legitimate grey market in CPUs identified the following market opportunities:

> (1) Sub-distribution, ie purchasing goods from an authorised distributer and selling on to an assembler;
>
> (2) Distribution of obsolete and/or niche components such as military electronic components or specialised components that are no longer manufactured;
>
> (3) an emergency supply of components;
>
> (4) Offload of an excess inventory; and
>
> (5) Arbitrage as a result of geographical price differences leading to international trade.

His report set out the following guidance in his report to distinguish the legitimate from the illegitimate grey market:

(1) If the product description, on the invoice or purchase order, is insufficient to uniquely identify the component, then a normal businessman will be unable to price the component. It therefore provides evidence that the trades do not represent part of the legitimate grey market;

(2) If the price is significantly different (eg more than 20%) than the Intel or AMO CPU list price then it could be concluded that the businessman is not able to price his, or her, products correctly. If this is observed across a significant number of deal chains then it is possible to conclude that the businessman is not trading in a normal commercial manner and may not be part of the legitimate grey market in CPUs;

(3) If the company is exceeding the projected legitimate grey market in CPUs from the UK then it is highly likely that the company is operating in another market than the UK legitimate grey export market in CPU components; and

(4) If the deal chains examined show significant repeating patterns (in sale price, volumes and profit margins) and do not conform to a typical deal chain as described in Section III, it is possible to conclude that the company is not operating in the legitimate grey market. Additionally, if prices at the beginning of a "back to back" deal chain are successively and repeatedly different from the price achieved by the last participant then one can conclude that the earlier participants in the chain are behaving un-commercially in that they do not achieve the available prices in the market place at that time.

87. Dr Findlay's estimate of legitimate grey market exports for 2006 was £1.4 million for Intel CPUs which results in a monthly export average of £116,000 for these products. The level of Imenex's turnover for April 2006 was £2,162,660, made up almost entirely from the export of CPUs despite the assertion of Mr Edwards that, "obviously I wasn't as big as a lot of people."

88. The typical deal chain described by Dr Findlay in the excess inventory opportunity follows the pattern Manufacturer – Assembler/Authorised Distributer ("AD") – Broker – Assembler and for an arbitrage opportunity Manufacturer – AD (Country A) – AD (Country B) – Assembler. In his report Dr Findlay explains that in each market opportunity he "would not expect to see long deal chains, ie with more than four parties in a deal chain as this would dilute profit margin." In evidence he confirmed that this was the case and that he, "wouldn't expect to see many [parties in a deal chain] in one country because of the simple fact that prices in one area sent to be similar."

Law

89. The right to deduct input tax is now derived from Articles 167 and 168 of Council Directive 2006/112/EC (previously Article 17 of the Directive 1977/388/EEC, the Sixth Directive). This has been implemented into UK domestic law by ss 24-26 Value Added Tax Act 1994 and Regulation 29 of The VAT Regulations 1995. However, an exception to this right was identified by the European Court of Justice ("ECJ") (as the

Court of Justice of the European Union ("CJEU") was then known) in its judgment of 6 July 2006, in the joint cases of *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04) [2006] ECR 1 – 6161 ("*Kittel*") in which it stated:

> "[51] … traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing the right to deduct the input VAT.
>
> [52] It follows 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 other fraud."
>
> …
>
> [56]. … a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
>
> [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 do so even where the transaction in question meets the objective criteria which form the basis of the concept of "supply of goods effected by a taxable person acting as such" and "economic activity".
>
> …
>
> [61] … 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 the fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."

90. The decision of the ECJ in *Kittel* was considered by the Court of Appeal in *Mobilx Ltd (in Administration) v HMRC; HMRC v Blue Sphere Global Ltd ("BSG"); Calltel*

Telecom Ltd and another v HMRC [2010] STC 1436 ("*Mobilx*"), where Moses LJ, giving the judgment of the court, said:

> "[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."

91. It is clear from *Mobile Export 365 v HMRC* [2007] EWHC 1737 (Ch), at [20], that when applying the *Kittel* test the Tribunal is entitled to rely on inferences drawn from the primary facts. It is also clear, from the approach taken by Christopher Clarke J in *Red12 v HMRC* [2010] STC 589 which was adopted by Moses LJ in *Mobilx* that the Tribunal should not unduly focus on whether a trader has acted with due diligence, as it did in *BSG*, but consider the totality of the evidence.

92. Moses LJ said, at [83] of *Mobilx*:

> "… I can do no better than repeat the words of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563:-
>
> [109] "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 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.
>
> [110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the

> fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> [111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them.'"

93. It is not disputed that HMRC bears the burden of proof in this appeal. As Moses LJ said, in *Mobilx* at [81]:

> "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."

Although the standard of proof was not considered in *Mobilx* it is accepted that the civil standard, the balance of probabilities, applies (see *Re B* [2009] 1 AC 1). As Lady Hale giving the judgment of the Supreme Court in *Re S-B (Children)* [2010] 1 AC 678 said, at [34]:

> "… there is no necessary connection between the seriousness of an allegation and the improbability that it has taken place. The test is the balance of probabilities, nothing more and nothing less."

Discussion

94. In an appeal, such as the present, the Tribunal has to determine the following issues, as set out by Sir Andrew Morritt C at [29] of *Blue Sphere Global v HMRC* [2009] STC 2239:

> (1) Was there a tax loss?
>
> (2) If so, did this loss result from a fraudulent evasion?
>
> (3) If there was a fraudulent evasion, were the appellant's transactions which were the subject of this appeal connected with that evasion? and
>
> (4) If such a connection was established, did the appellant know or should it have known that its transactions were connected with a fraudulent evasion of VAT?

95. It is not disputed that, in this case, there has been a tax loss that resulted from fraudulent evasion and that all the transactions with which this appeal are concerned were connected to that fraudulent loss of tax. In giving evidence Mr Edwards agreed that he knew, at the time Imenex was carrying out the deals in question, that the

industry in which it was engaged was one that was subject to widespread fraud. Moreover it was accepted that he was clearly aware of the extent and prevalence of MTIC fraud at this time.

96. Therefore the issue to be determined is whether Imenex, through its director Mr Edwards, knew or should have known of that connection. In considering this issue it is clear from *Mobile Export 365 v HMRC* [2007] EWHC 1737 (Ch), at [20(4)], that we are entitled to rely on inferences drawn from the primary facts.

97. It is also clear, from the approach taken by Christopher Clarke J in *Red12 v HMRC* [2010] STC 589 which was adopted by Moses LJ in *Mobilx* that we should not unduly focus on whether a trader has acted with due diligence but consider the totality of the evidence. As Moses LJ said:

> "[82] 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 the 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.
>
> … I can do no better than repeat the words of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563:-
>
> > [109] "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 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.
> >
> > [110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as

> part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> [111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them.""

98. However, as Mr Yeo reminded us, Judge Poole said in *The Hira Company Limited v HMRC* [2011] UKFTT 450 (TC) (with his emphasis):

> "[115] … when considering "a wide range of factors" it is difficult to be forensically analytical about when a trader's "suspicion" of a connection with fraud actually hardened into "knowledge" of that connection; and only marginally less difficult to say when that hardening <u>should</u> have taken place.
>
> [116] A very convincing picture will need to be painted before a tribunal can make an inferential finding of actual knowledge of a connection to fraud. Whilst a tribunal should not shy away from such a finding where it feels the evidence supports it, a finding that a trader <u>should</u> have known of a connection to fraud will by definition be much less hard to make – it requires the tribunal only to exercise its own judgment based on the established facts, rather than to look inside the head of the trader (or that of each relevant individual within a corporate trader). But in either case, the approach should be to consider all the evidence in the round and then reach an overall judgment, rather than to consider particular pieces of evidence in isolation then attempt to synthesise the results of that consideration into a single overall finding."

99. Mr Yeo, for Imenex, contends that this is in essence a case which can be explained simply as "a man bought some CPUs and sold them at a profit". There is, he submits, no "knock-out blow" or piece of evidence which strongly points to the Mr Edwards and Imenex being a knowing participant in the fraud rather, properly looked at the evidence strongly points away from Imenex knowing or indeed suggesting that it should have known and that, as such, HMRC have failed to discharge the burden upon them to prove that Imenex knew or should have known that each, or any, of the 13 deals relied upon were connected to fraud..

100. He reminds us that it is not for Imenex to prove its trade was legitimate, rather for HMRC to prove that it knew or should have known it was not. In this case, he says, the evidence shows that Imenex was a legitimate trader that unwittingly became victim of a fraudulent scheme.

101. For HMRC Mr Puzey submitted that this case was not an archetypal MTIC case concerning an inexperienced trader with no prior knowledge or understanding of the market in which he operates who seizes what is perceived to an opportunity to make a substantial and effortless financial gain but rather a "smart MTIC case" and that the case advanced for Imenex of a man buying CPUs and selling them for a profit is a fallacy.

102. Mr Puzey submits that, given it relies on the honesty and legitimacy of ATP (one of its principal suppliers) and Solid (one of its principal customers), Imenex cannot be a victim of the fraud as that is only possible if an innocent trader has been "ring-fenced" by fraudsters as happened in *Else Refining and Recycling Limited v HMRC* [2012] UKFTT 470 (TC) as described by Judge Walters QC where he said, at [57]:

> "We consider it is certainly possible (and may indeed be likely) that the organisers of the fraud saw a benefit in using a 'patsy' (or unknowing party whom they manipulated) as the 'Broker' in the chain – that is, the party who would claim a refund of VAT from HMRC. Further, we consider it possible (and maybe likely) that the organisers of the fraud had sufficient flexibility of approach that if a broker in the position of Else [the appellant] decided to sell to one party rather than another, then the chain could be maintained, either by the supplier to the broker pulling out, or, more likely, an onward sale being arranged to be made by the customer chosen by the broker, which onward sale would resurrect the chain. In making this suggestion we are inferring from the evidence that all the (relatively few) parties which Else might have chosen as its customer – the 'pool' of customers to which JE made reference – had positioned themselves to be the entities which Else would most likely contact with offers to sell product and were knowingly involved in the fraud."

Mr Puzey contends that while it may be possible for fraudsters to position themselves around a single entity in order to exercise sufficient control to perpetuate a fraud such a degree of control would be lost where up to three innocent parties had been involved in a deal as claimed in this case in deal 13.

103. Clearly the transactions with which this appeal is concerned do not conform to the description of the legitimate grey market as described by Dr Findlay in his report, eg the deal chains in the transactions undertaken by Imenex are somewhat longer than those anticipated by Dr Findlay in his analysis of the legitimate grey market.

104. In the circumstances we do not find the explanation by Mr Edwards of the increase in trade in 2006, namely that his customers bought more from Imenex "because they had demands, they had bigger demands", to be credible especially as the spike in trade is comparable to what had happened in 2001 where an increase in turnover was the result of illegitimate grey market trading by Imenex albeit in mobile telephones. At the very least we would have thought this would have been enough to raise suspicions that something similar was occurring in March 2006.

105. It is now accepted that there was indeed something similar happening at that time and that the transactions entered into by Imenex with which we are concerned were connected to a fraudulent loss of tax. As such it is necessary to consider whether Mr Edwards and Imenex knew, or should have known of that connection or if, as has been submitted by Mr Yeo, it was the unwitting victim of the fraud.

106. Mr Weeks formerly of ATP and Mr Dasbach of Solid gave evidence on behalf of Imenex. It was not suggested that either had manipulated or manoeuvred Imenex into making the deals which had taken place. Rather the evidence of Mr Weeks and Mr Dasbach was to the effect that they were legitimate businessmen and that their companies had entered into genuine commercial transactions with Imenex and their customers and suppliers and, as such, should also be regarded as innocent parties in relation to the MTIC fraud arising out of the transactions concerned.

107. However, given Judge Walter's description of how a single innocent party may become embroiled in the fraud in that case and its similarity with what happened to the appellant in *JDI Trading Limited v HMRC* [2012] UKFTT 642 (TC) we accept Mr Puzey's submission in the present case that while it may be possible for fraudsters to position themselves around a single entity in order to exercise sufficient control to perpetuate a fraud such a degree of control would be lost if there were three innocent parties as claimed in this case, Imenex, ATP and Solid at least two of which were involved in all deals, with the exception of Deal 7, and all three participated in Deal 13.

108. It therefore follows that we do not accept that Imenex was an unwitting victim of the fraud. It must also follow that if Imenex was not a victim of the fraud it must have known that its transactions were connected to it.

109. Such knowledge would explain why Mr Edwards did not consider it necessary to implement the recommendations contained in the EY Report. Also it is clear that the failure to do so would severely limit the effectiveness of the EY Report as a potential shield providing Imenex with "good grounds for a robust defence" and putting it "in a good position to challenge any withheld VAT repayments" in the "unlikely event of a dispute" with HMRC given the Report's conclusion (see paragraph 81, above) that this is dependent on "Ernst & Young's recommendations" being accepted.

110. The lack of action by Imenex to act on the EY Report can be contrasted with the actions of the appellant in *JDI Trading v HMRC* (at [216]) which, when faced with evidence of circularity of goods, first sought the advice of its adviser PwC who had carried out due diligence on its behalf before writing to HMRC "to report this suspicious incident" which the Tribunal considered to be "not the typical reaction of a fraudster". However, in our view the request by Imenex in its "Supplier VAT/Trading Status Form" (see paragraph 62, above) asking HMRC to "refrain from damaging the presentation of the box by defacing it the manufacturers packaging with your identification stamps" and Mr Edwards inadequate explanation which we have noted at paragraph 64, above, very much is.

111. Also being such a participant in the fraud would also explain the 266% increase in its turnover from £8,176,235 in its financial year ending 31 March 2005 to £21,806,114 in its equivalent period twelve months later.

112. However, even if Imenex was not a knowing participant we find, for the above reasons, that the only reasonable explanation for the transactions in which it was involved was their connection with the fraudulent evasion of VAT and that Mr Edwards and therefore Imenex should have known that this was the case.

Conclusion

113. For the above reasons we dismiss the appeal.

Right to Apply for Permission to Appeal

114. 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.

JOHN BROOKS
TRIBUNAL JUDGE

RELEASE DATE: 3 March 2015