[2016] UKFTT 152 (TC)

TC04938

Appeal number: LON/2007/1649
LON/2007/1650

VAT – MTIC – contra-trading – Fonecomp considered – knowledge of details of contra-traders - lack of primary evidence of some deals in chain- knew or should have known – director's previous experience of fraudulent transactions–indicators of fraud – Held – knew deals fraudulent – due diligence smoke screen –previous experience and knowledge of fraudulent transactions strong indicators - HMRC not required to demonstrate knowledge of specific link between contra-traders and Appellants in chain – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Abbott International Trading Limited **Appellants**
Stamill Limited

- and -

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

TRIBUNAL: JUDGE Rachel Short
Christopher Jenkins (Member)

Sitting in public at the Royal Courts of Justice, the Strand, London on 20 – 24 April and 28 April 2015

the Appellant not appearing

Mr Bryant-Heron QC and Ms Natasha Barnes, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

1. This is an appeal by the Appellants, Abbott International Trading Limited ("Abbott") and Stamill Limited ("Stamill") against HMRC's decision of 18 September 2007 to disallow input VAT amounting to £7,956,952.51 for periods 03/06, 04/06 and 05/06 for Abbott and £5,497,920.58 for periods 03/06, 04/06 and 05/06 for Stamill. Both of those decisions were appealed on 20 September 2007 and were consolidated under Rule 5 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 by a direction of 22 December 2014.

2. This is a Missing Trader Intra-Community fraud ("MTIC") case in which the onus is on HMRC to demonstrate that the Appellants' right to deduct input tax has correctly been denied on that basis that:

(1) A fraud has been perpetrated on HMRC.

(2) That fraud caused loss to HMRC.

(3) Each of the Appellants' disputed transactions was connected to that fraud.

(4) The Appellants knew of that connection or should have known of that connection.

3. According to HMRC the Appellants' transactions form part of a "contra-trading" scheme, a particular type of MTIC transaction, in which standard rated goods are purchased in the UK by a broker through a supply chain which starts with a trader who has defaulted on his obligations to account for output tax in the UK. Goods are exported to the EU and are zero-rated and goods of a similar value, but not necessarily of the same type, are acquired. Those goods are sold in the UK through a series of brokers who ultimately export the goods to the EU as a zero-rated supply and re-claim the related input tax from HMRC. HMRC's case is that Abbott and Stamill are involved in such a contra-trading scheme as UK brokers reclaiming input tax from HMRC.

Preliminary issues

4. A direction was issued on 7 November 2014 that the Appellants should confirm the specific factual matters which were in dispute. At a hearing on 23 January 2015 the Appellants responded to that direction accepting some but not all of HMRC's submissions in respect of HMRC's case relating to the issues set out at paragraph 2 (1) – (3) above. Further detailed disputes with various aspects of HMRC's arguments in respect of those issues were raised at this hearing and we have responded to each of these.

5. This decision proceeds on the basis that the main issue between the parties is whether the Appellants knew of the connection of the disputed transactions with

fraud, or if they did not have actual knowledge of the connection with fraud, whether they should have known of that connection.

6. The Appellants shared a director in the person of Ms Laura Messham who provided the main evidence and arguments on their behalf. The question of the Appellants' knowledge or means of knowledge of the connection of these deals with fraud is therefore primarily a question of Ms Messham's knowledge.

7. The disputed deals, amounting to 52 in total (30 for Abbott and 22 for Stamill) are set out in the schedule to this decision and are referred to by the numbers given there.

8. In the process of considering the evidence produced by the Respondents after the hearing the Tribunal noted a number of errors in the deal overview documents referred to by the Respondents during the hearing. The Respondents corrected those errors and an amended form of the deal overview documents was provided to the Appellants on 2 November 2015. The Appellants did not make any further representations in respect of those amended details.

The law

9. The relevant EU legislation which sets out a VAT registered trader's right to reclaim input tax was, for the periods concerned, the Sixth VAT Directive (77/388/EEC), at Article 17. The UK legislation implementing the Directive's rules about input tax reclaims is in sections 24 to 26 Value Added Tax Act 1994. These provisions state that if a registered trader has suffered input tax which is allowable, he has a right to offset this against his output tax liability or receive a repayment if the input tax exceeds the output tax due.

10. European cases have decided that the general rule in Article 17 is subject to an exception in the following circumstances :

> " *a taxable person who knew, or should have known that, by his purchase, he was taking part in a transaction connected with the 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 re-sale of the goods.*
>
> *That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.*
>
> *In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions is apt to prevent them.*
>
> *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 .*"

(Axel Kittel v Belgian State & Belgian State v Recolta Recycling SPRL (joined cases – C-439/04 & C- 440/04) [2006] ECR 1 – 6161).

11. The UK's own courts have commented on the application of the *Kittel* decision in *Mobilx Limited (in liquidation) v HMRC [2010] EWCA Civ 517 ("Mobilx")* a decision of the Court of Appeal:

> "*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......*
>
> *If he chooses to ignore the obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct….."*

12. In *Fonecomp Ltd v HMRC* ([2015] EWCA Civ 39) the Court of Appeal has recently considered the extent of the knowledge required in order to demonstrate that a trader knew or should have known that his transactions were connected with fraud, concluding that specific knowledge of the fraudulent deals in not required :

> "*He simply has to know, or to have the means of knowing, that fraud has occurred, or will occur, at some point in some transaction to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge*". Arden LJ at para [51].

13. The onus of proof is on HMRC to demonstrate to the civil standard that the Appellant companies knew or should have known that each of the 52 transactions under appeal was connected with fraudulent tax losses.

Authorities referred to:

14. *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL (C-439/04 and C-440/04)[2006] ECR I – 6161*

15. *Bonik EOOD Case C-285/11*

16. *Blue Sphere Global Limited v HMRC* [2009] EWHC 1150(Ch)

17. *Eyedial Limited v HMRC [2013] UKUT 0432(TCC)*

18. *Electrical Environmental Services Limited v HMRC* [2014] UKFTT 0129.

19. *Fonecomp Ltd v HMRC* [2015] EWCA Civ 39

20. *HMRC v S&I Electronics PLC v HMRC* [2015] UKUT 418 (TCC)

21. *Mahageben and David (joined) Case C-142/11and C-80/11*

22. *Megtian Limited v Commissioners for HM Revenue & Customs* [2010] EWHC
5 18 (Ch)

23. *Mobilx Limited (in liquidation) v HMRC [2010] EWCA Civ 517*

24. *Universal Enterprises (EU) Ltd v Revenue & Customs Commissioners* [2014] STC 1515

10 **Evidence**

25. We were informed on 15 April 2015 that Ms Messham, director of both Appellant companies was not available to attend the Tribunal as the result of the illness of her partner. We were also informed during the course of the hearing that Mr Stephen Plowman, witness for the Appellants, would not be attending the Tribunal.
15 We were told that the Appellants' advisers were not able to present the case at the Tribunal because they had ceased to act as of 15 April 2015.

26. Ms Messham had however produced three written witness statements, dated 18 January 2008, 5 April 2009 and 27 July 2012 and we were asked to consider the opening submissions prepared by her advisers before they came off the record.

20 27. We also saw the witness statement of Stephen Plowman, director of Veracis Limited ("Veracis") who were employed to carry out some due diligence for the Appellants, dated 27 March 2009.

28. In the absence of any cross-examination of the witnesses for either side and the absence of any oral evidence given on behalf of the Appellants we have produced the
25 witness evidence in the decision so that as far as possible the written evidence provided by the Appellants is set against the written and oral evidence provided by HMRC.

29. We heard oral evidence from Mr Munroe-Birt, higher officer of HMRC, who also produced two witness statements dated 25 June 2009 and 28 November 2011.

30 30. We were also directed in particular to the following witness statements prepared on behalf of HMRC. None of these witnesses gave oral evidence before the Tribunal:

(1) Mr Mody who produced two witness statements dated 24 November 2011 and 4 March 2013 dealing with aspects of the contra-traders to whom HMRC say these disputed deals are linked.

(2) Mr Wilkinson officer of HMRC, whose evidence concerned the UK freight forwarder SPF Freight and Logistics Limited ("SPF") in a witness statement dated 28 October 2010

(3) Mr Mendes, officer of HMRC, whose evidence derived from information held by computer servers held at the First Curacao International Bank NV ("FCIB"), tracing payments made through FCIB accounts which were connected to the Appellants' deals and the IP addresses from which those payments were made, in a witness statement 29 January 2015. (An IP address is an "internet protocol address" which is specific to a particular computer location or gateway).

(4) Mr Birchfield officer of HMRC whose evidence also dealt with the flow of funds demonstrated by the FCIB server evidence and the patterns of trading undertaken by the contra-traders, in a witness statement of 3 February 2015

(5) Mr Corkery, a partner at Ernst and Young, whose evidence covered patterns of trading in the so called "grey market", in a witness statement of 15 December 2014

(6) Mr Schuitema officer of HMRC whose evidence covered the insurance documents entered into by the Appellants, in a witness statement of 7 September 2010

(7) Mr Humphries, a senior officer of HMRC, provided evidence about the overall structure of the scheme of which HMRC suggest the Appellants' deals are part relying on the FCIB server evidence and giving details about the so called "Malaga cell", in a witness statement of 20 January 2010

(8) Mr Downer an officer of HMRC provided evidence relating to the freight forwarder Worldwide Logistics and Mr Monster, director of that company, in witness statements of 19 November 2009 and 20 January 2010.

(9) Mr Letherby an officer of HMRC also provided a report dated 29 November 2011 and we were referred to his evidence about the use of IP addresses.

Witness Evidence

31. Mr Munroe-Birt was HMRC's officer for Keybeam Technology Limited ("Keybeam") a company with which Ms Messham was involved before her involvement with the Appellants and also visited Stamill for its pre-registration visit. He knew Ms Messham because of her involvement with Keybeam.

32. The original officer dealing with Abbott and Stamill retired in 2011 and Mr Munroe-Birt took over the role as witness in this case. In doing so he relied on the evidence previously served by the former officer, Ms Magnay, and the exhibits to her witness statements.

33. HMRC said that in the absence of Ms Messham and Mr Plowman and the consequent lack of cross-examination of some key aspects of the Appellants' witness evidence, the Tribunal should give limited weight to the statements made in the Appellants' witness statements, some of which HMRC considered to be of debateable veracity.

History of the Appellant companies

Ms Messham

34. Ms Messham maintained that both the Appellants were established, well regarded traders with a strong reputation in the wholesale trading markets for "sim free" mobile phones and computer processing units ("CPUs"). It was not the case that two companies were used to reduce the size of the VAT reclaims made by a single entity.

35. Stamill started trading in November 2003. Ms Messham explained that she built up its business by attending trade fairs (CEBIT) and used specialist internet trading sites (IPT and ICB).

36. Abbott was formed in 2004 on the advice of Veracis who suggested that a new company be formed so that Stamill could be used for UK to UK trading only. As was common in the market at that time, a separate company, Abbott would be use for EU transactions.

37. It was Ms Messham who made the decisions for both of these companies about who they would do business with. She said *"Such decisions took account of the commercial due diligence Abbott and Stamill carried out on its proposed suppliers and customers and also on the commercial sustainability and viability of the transaction*" No deals were arranged or placed and received without her personal approval.

38. It was not disputed that Ms Messham was the directing mind of both the Appellant companies. Ms Messham said that HMRC had never raised any concerns with the way Abbott or Stamill were operated.

Ms Messham's experience

39. Ms Messham herself had been involved in the industry for six years and stated that she took her corporate responsibilities seriously. Her experience included working for Keybeam as a broker and administrator. She was keen to stress that she had not been a director of that company and had been involved in its day to day business only when those who were more senior than her were not available due to ill-health. She was not involved in any decision making regarding Keybeam's activities,

but her duties did include verifying VAT numbers. She was not aware of Keybeam being at high risk of MTIC fraud.

Mr Munroe-Birt

40. Mr Munroe-Birt said that in all his dealing with Keybeam, Ms Messham had been his main contact and that as far as he was aware, although she was not a director of that company, she was running it on a day to day basis. Mr Munroe-Birt also told us that Ms Messham had been a director of a company called Slimline Computer Systems Limited which HMRC believed to be involved in MTIC trading and which was compulsorily deregistered for VAT in February 2003.

41. In Mr Munroe-Birt's view Ms Messham did not appear to be an impressive business woman who understood her business. She did not seem very knowledgeable about the market she operated in or how she was adding value by importing and exporting in the way in which she did. Stamill's operating premises when he visited were Ms Messham's private address; a small house on a housing estate.

Relationship with HMRC

Ms Messham

42. Ms Messham said that she was co-operative with HMRC at all times and had never been criticised by HMRC for the information which she provided nor had it been suggested that there was any way in which her documentation or trading methods could be improved. She said any difficulties with arranging meetings arose from HMRC's problems in setting dates for meetings and changes or personnel rather than her issues (she referred to the attempts to arrange a meeting with HMRC in December 2006).

43. She worked well with HMRC and prior to the periods in dispute received regular and prompt repayments from HMRC. She voluntarily provided deal pack documentation to HMRC. HMRC visited three times during 2005 and 2006 and did not raise any concerns with the companies' procedures. Ms Messham referred in particular to a meeting with HMRC in November 2005, at which Mr Plowman was also present; she provided all necessary documents and HMRC were happy with her responses. The same was true for the meeting of 7 February 2006. She confirmed that she was aware of VAT Notice 726 and the guidance which it contained about MTIC fraud.

Mr Munroe-Birt

44. Mr Munroe-Birt did not describe Ms Messham's behaviour as co-operative. His view was that her only co-operation with HMRC was when she was chasing payments from HMRC. In other circumstances she had not provided required information and on at least one occasion her behaviour when he made an unannounced visit in September 2003 had been very suspicious: "*there were frantic calls and shouting up*

to whoever she could – whoever's attention she could attract on the first floor there to presumably stop me observing something she didn't want me to see"

45. Ms Messham had received letters from HMRC about MTIC fraud and about the need to identify suppliers of OEM (Original Equipment Manufacturer) products, in particular HMRC's letter of 1 November 2004 to Abbott setting out the extent of MTIC fraud. Ms Messham had said that she wanted to move away from "*the murky world of supplying phones and CPUs*" at their meeting on 10 June 2003. She was well aware of the contents of VAT Notice 726 "Joint and Several Liability" which set out HMRC's guidance for guarding against being involved in MTIC fraud.

46. Ms Messham also had information about MTIC fraud from two occasions on which she was interviewed on caution concerning Keybeam's transactions, on 18 May 2004 and 27 June 2006.

Evidence about fraudulent tax loss and links to contra-traders

Ms Messham

47. Ms Messham maintained that she did not have knowledge or means of knowledge of the tax fraud alleged in these wider chains of supply, the contra-traders and "dirty chains", having never met or dealt with any of those traders. She disputed how HMRC had linked the Appellants' legitimate and commercial transactions to transactions in this wider supply chain. In particular, she said HMRC had relied on evidence which was available to them only after the trades had taken place and was not available to the Appellants at all.

48. Ms Messham's general approach was that she had no knowledge of the parties in the "clean chain" other than those with which the Appellants dealt directly and no knowledge of the parties in the "dirty chain" at all. Moreover, she stated that she had no knowledge or understanding of contra-trading. Abbott and Stamill did not know their suppliers' suppliers or their customers' customers. She knew that there was MTIC fraud in this market, but did not know that it was "rife". She did not know how this fraud operated. Her experience of this while at Keybeam was limited; she was guided by more senior personnel when she was there.

49. Ms Messham said that she could not comment on aspects of HMRC's evidence which concerned traders other than those which the Appellants had dealt with directly. However, her advisers did submit detailed comments in response to these aspects of HMRC's evidence in three schedules setting out each element of the fraudulent tax loss chains and contra-traders for which they contended HMRC had not submitted sufficient evidence.

Mr Munroe-Birt

50. HMRC responded to these points during the course of the Tribunal hearing, submitting that these 52 disputed deals were orchestrated as shown by the FCIB

evidence and the common IP addresses which strongly suggested that all deals were being input from the same computer, as made clear by the evidence of Mr Mendes and Mr Letherby. Either Ms Messham was doing all of the deals from her computer or she had given her log in details to someone else who was doing them. The whole chain of transactions only worked if the Appellants' suppliers and customers were pre-designated. If Ms Messham was not aware of the whole of the scheme as she maintained, she must have been directed by someone who was.

Due Diligence

Customers

Ms Messham

51. Ms Messham said that she relied on her good market product knowledge to protect her from being caught up with fraudulent transactions and that she had used Mr Plowman at Veracis to verify her customers. They advised her at the end of 2003 to use Stamill only for UK to UK trades and that is why she set up Abbott as an exporting company.

52. In Ms Messham's view, HMRC's case was based on retrospective criticisms of her procedures and was selective. She pointed out that there was no legal requirement to follow HMRC's Notice 726 guidelines or to keep records of International Mobile Equipment Identity ("IMEI") numbers.

53. She would get to know customers and suppliers by regularly speaking to them by telephone and would carry out a personal visit before first dealing with any entity. Details of inspections by customers were done over the phone before the written reports were received, so there was no need to wait for written confirmation. She provided details of her contacts with each of the three customers who were party to the disputed transactions:

> (1) *Neo Abaco GmbH*– She had no reason to believe that this company was involved in anything untoward. She visited their premises and knew the director of the company.
>
> (2) *Olympic Europe BV* – She was satisfied that this company was a bona-fide trader, their offices were visited by a member of Stamill. Their director also visited the Appellants' offices in the UK.
>
> (3) *Essential Trading SRL* – She visited their offices in Paris and exchanged company details before trading with this company for the first time in June 2005.

54. To reduce commercial risk, the Appellants would take a large deposit before releasing goods to customers if goods were not fully paid for before release. She gave the Tribunal details of due diligence done for each of the customers involved in the disputed transactions, including obtaining a trade application form, bank and company

information, a letter of introduction, VAT registration verification and copy of personal identification documents for the director and a completed supplier questionnaire.

55. In each case she said that she knew the directors of the companies and had visited their offices in Europe. She pointed out that she carried out due diligence on these companies despite being protected by the Appellants' practice of only releasing goods when they had been paid for.

56. Ms Messham denied links between the Appellants and other companies who HMRC said were involved in MTIC fraud such as Big Store Limited and IT Fast Track Limited, who she said she had never traded with. She did accept a link with Evolution Export Limited through the sale of a share in an executive box at Chelsea football club.

57. She provided goods inspection reports, VAT number checks and other documentation to HMRC and this documentation was never criticised. Her due diligence was "*reasonable, effective and proportionate*".

58. Ms Messham said that she had made a "*reasonable and proportionate commercial decision*" not to record IMEI numbers or CPU box numbers, not having the necessary systems in place and no resources or technical knowledge to be able to do this. She did not know of the existence of HMRC's "nemesis database" with IMEI numbers.

59. *Redhill checks*. Ms Messham said these were done and it was not stated by HMRC that these should be done immediately before trading. (Redhill checks are a means of confirming with HMRC that a company remains validly registered for VAT in the UK).

Mr Plowman, director of Veracis.

60. Mr Plowman's witness statement supported the fact that Veracis had been appointed by the Appellants as tax consultants. Mr Plowman said that Ms Messham had been co-operative with HMRC and had followed the advice which Veracis had given her about the due diligence which should be done. Veracis had produced 23 site visit reports for the Appellants.

Mr Munroe-Birt

61. HMRC pointed out the entities who were the Appellants' customers were themselves implicated in MTIC fraud. Mr Munroe-Birt disputed the extent of Ms Messham's market knowledge and whether she dealt in a real market at all; he pointed out that her suppliers and customers were very limited.

62. Mr Munroe-Birt said that the keeping of IMEI numbers or other serial numbers was essential commercially if a company was running a proper returns policy for goods sold.

63. From HMRC's perspective it was logical and commercial to do Redhill checks just before trading with a particular entity. HMRC referred to other possible sources of information such as the National Advice Service ("NAS"). Mr Munroe-Birt provided a schedule setting out the dates when Redhill checks had been done on the Appellants' customers and suppliers which demonstrated that in most cases checks were done either some time before or sometime after deals were actually entered into. Redhill checks were carried out by Abbott on Nobel Technologies Limited in October 2004 and by Stamill in July 2004 and January 2006. Redhill checks were carried out by both Appellants on Neo Abaco GmbH in February 2006.

Suppliers – Nobel and Trade 24/7

Ms Messham

64. Ms Messham referred to the support which she obtained from Veracis who she described as an independent professional firm, who provided her with additional reassurance that the Appellants could trade with a company. Their reports did not in themselves mean that Abbott or Stamill would trade with a particular entity but did give a better commercial understanding of potential trading partners. Her due diligence checks were real and comprehensive and she did not ignore the negative indicators in the Veracis reports.

65. Ms Messham said that she dealt with trusted suppliers established in the market. Her two main suppliers were Trade 24/7 Limited ("Trade 24/7") and Nobel Technologies Limited, t/a Nobel Wireless ("Nobel") who were trusted suppliers.

66. Ms Messham provided a list of the due diligence documents which she had obtained for both of these suppliers and said that she visited their premises before commencing trading with them and conducted a full company search. Ms Messham explained the development of her relationship with her suppliers.

67. *Nobel* – Ms Messham said that she first met Mr Omer director of Nobel in 2003 and built up a relationship, visited their offices and was shown their compliance manual, produced by KPMG. She visited Nobel about four times a month in London and Manchester during 2004, 2005 and 2006. She gave an example of the due diligence documents obtained for Nobel which amounted to 23 pieces of information including the director's passport, the Veracis due diligence form, VAT registration confirmation, companies' house documents and a search against the director in person plus copies of invoices and a trade reference from Rioni Ltd. She said that Nobel was a long time supplier to the Appellants and HMRC had not raised issues with them prior to these periods

68. *Trade 24/7* Ms Messham said that she had known the personnel at 24/7 for a number of years and did not see any pattern of trades which would have caused her concern. She knew one of directors, Mr Cicopalus and visited his premises where he appeared to run a successful thriving bona-fide company. Ms Messham also provided 5 a list of the due diligence carried out for this entity similar to that provided for Nobel.

Mr Munroe-Birt

69. Mr Munroe-Birt pointed out that the negative indicators referred to by Veracis in their due diligence documents were not followed up, blank responses to significant 10 questions such as in the Suppliers Questionnaire for Nobel, were not queried. He said "*The due diligence has the appearance of being designed to convince HMRC that reasonable checks have been carried out rather than for any true commercial purpose*". The Veracis report on Nobel was received by Ms Messham on 6 July 2006, after the disputed deals with that entity had been done.

15 70. Other aspects of the due diligence which Ms Messham said the companies carried out was incomplete or provided questionable information; supplier declarations were often incomplete and no credit checks were done on trading partners.

71. Ms Messham had been told that Trade 24/7 also used Veracis for their due 20 diligence but no questions had been raised about whether this caused any conflict issues for the Appellants.

Freight forwarders

Ms Messham

25 72. According to Ms Messham, all the goods traded in each of the 52 disputed deals physically existed, this had been confirmed by the freight forwarders used by the Appellants; Advanced Contract Services Ltd ("ACS") and SPF Freight and Logistics ("SPF") in the UK and Worldwide Logistics in the EU. HMRC themselves had visited the freight forwarders. The freight forwarders were picked by reference to the 30 freight forwarders used by suppliers so that the ship on hold conditions could be relied on. She had no concerns with the freight forwarders and HMRC had not raised concerns about them either. She had carried out due diligence on the freight forwarders and either she or a member of staff had viewed the stock at the freight forwarders in March, April and May 2006.

35 73. She ensured that inspections were carried out by the freight forwarders and "*there was almost always a member of staff from my companies present at these inspections*" a 100% box count was done but because it was too expensive to break the seals and inspect every phone, often a small sample of boxes would be opened.

She pointed out that some freight forwarders did not allow third parties to inspect goods at their premises.

Mr Munroe-Birt

74. HMRC said that the Appellants should have required much more significant 5 assurances from the freight forwarders than they obtained, including carrying out credit checks and ensuring that warehouses were secure. There was no evidence of any due diligence having been done on the EU freight forwarders, despite the heavy reliance placed on the “ship on hold” instructions given to them.

75. HMRC pointed out that Ms Messham or a representative of the Appellants had 10 not visited their EU freight forwarders at all and cast doubt on the extent of the due diligence carried out on the UK freight forwarders given what HMRC’s own inspectors found at those premises, namely no goods of the description which were supposed to be in transit at the relevant time.

76. Mr Munroe-Birt said that there was no evidence of actual inspection of any of 15 the goods and the responses received to due diligence queries from suppliers, customers and freight forwarders was basic and often had information missing which was not followed up.

Mr Downer

77. Mr Downer provided information about the Appellants’ EU freight forwarder 20 Worldwide Logistics and its director Mr Monster. The Dutch authorities had concluded that Worldwide Logistics had produced false CMRs, 40 of which related to the Appellants’ deals. CMRs had also been signed for goods which did not exist including for Olympic Europe BV, one of the Appellants’ counterparties.

78. HMRC had also obtained evidence, from a computer disk found as part of a 25 murder investigation in May 2006, of the involvement of three of the contra-traders common to the Abbott and Stamill transactions in MTIC transactions prior to the time of these deals in mid to late 2005 and Stamill itself appeared in some of the trading chains. According to Mr Downer, this demonstrated a high level of orchestration of which the Appellants’ deals were a part.

30 **Mr Wilkinson**

79. Mr Wilkinson visited the premises of freight forwarders SPF and examined consignments of goods and relevant documentation.

80. Mr Wilkinson said that HMRC visited SPF in 2005 and were told that mobile phones would not be stored on their premises because of insufficient security and 35 insurance. Later that year it was established that mobile phones were stored at their premises. Mr Fenton, director of SPF, could not provide complete paper work relating to the transactions undertaken by SPF. The only goods which were found at the premises were old computer parts but documents showed that mobile phones had been moved from the warehouse on that day. HMRC visited the premises on 6 March 2006,

a date when Stamill's documents say that they inspected CPUs at the premises. No high value goods were at the premises on that date. Further visits carried out during June, July and August 2006 failed to identify any mobile phones at the premises.

81. In Mr Wilkinson's view SPF did not give the impression of being a legitimate business; failing to produce paperwork and having no stock record system. Its director, Mr Fenton had been associated with other UK freight forwarders who had also been implicated in fraudulent transactions.

External credit reports

Ms Messham

82. Ms Messham said that she did undertake some credit checks on customers and suppliers, but placed no great reliance on these because they could be misleading and in any event the Appellants were paid by their customers before they paid their suppliers.

Mr Munroe-Birt

83. HMRC considered that relying on oral confirmation of deals of this significance did not make commercial sense.

Insurance of goods

Ms Messham

84. Ms Messham said that understood that her goods were covered by insurance of the freight forwarders but after discussions with HMRC decided to get her own insurance with Delta Lloyd Schadeverzekering NV ("Delta Lloyd").

Mr Schuitema

85. Mr Schuitema provided evidence relating to the insurance contract entered into by Abbott with Delta Lloyds. He explained that according to Delta Lloyds, Abbott had been provided with blank insurance documents which they had completed themselves. It was not possible to make claims on the basis of these documents, which were not valid insurance contracts.

86. HMRC said that there was no proof that any payment had ever been made for insurance and the validity of the insurance documents themselves were in doubt and no insurance at all had been taken out until 2005 after conversations with HMRC.

Third party payments

87. It was accepted by HMRC that no third party payments were made by either of the Appellants, but the entities with which Ms Messham had previously been involved had made third party payments.

5

Structuring of the deals

Ms Messham

88. Ms Messham explained that the commercial documentation provided to the
10 Tribunal did not illustrate every step of the deal negotiations; she would negotiate the main commercial terms first of a deal first, get the purchase order from a customer, send their purchase order to supplier, instruct the freight forwarder, send ship on hold instructions, get an inspection report, then ship the goods. Once the goods got to their destination, she would obtain confirmation from the customer, the customer would
15 pay and then the Appellant would pay its supplier. There was however no one set format or procedure or order in which documents were received.

89. She confirmed that there were no written contracts of sale and purchase, but she said that this was common in the commodity wholesale business, which relied on written purchase orders and allocation and release notes. There was no return or
20 exchange policy because there was no commercial need for one for deals of this type.

90. Ms Messham said that paperwork was not retained for deals which were not completed and there were a lack of storage facilities to keep copies of documents for deals which were not actually done. She would conclude the commercial terms of a viable deal (stock model, colour, quantity and prices) to ensure supply and arrange
25 physical inspection, payment and delivery at a later stage. Her aim would be to match customers' demands with suppliers stock matching them as closely as possible. If larger batches were offered from suppliers than buyers required she would not agree the deal.

91. In her view there was no need to add value as a broker, the Appellants' skill
30 provided was sourcing goods to match customers' requests. There was nothing unusual in the mark ups made by the Appellants; they were not consistent and demonstrated a range of margins, varying from deal to deal, unlike HMRC suggested. She was sometimes prepared to trade at low margins in the interest of a longer term commercial relationship but factored in a minimum level of expenses to make sure
35 deals broke even.

92. Ms Messham said that her market was EU wide, as was standard practice, it was easy to convert EU to UK specification phones and vice-versa.

93. The invoices for deals were bunched towards the end of each of the three disputed monthly periods because the early part of the month was used for sourcing

and negotiating deals, which were settled towards the end of the month. There was no need for detailed legal contracts and terms and conditions, the majority of traders could deal with any issues commercially and amicably between themselves.

5 **Mr Munroe-Birt**

94. Mr Munroe-Birt said that there was little substantial paperwork for any of the disputed deals and that the description of the goods given in both supplier and purchaser invoices was too vague to be truly commercial.

95. There were some significant discrepancies in the documents which were 10 provided according to Mr Munroe-Birt; for example "ship on hold" instructions were given on dates before goods had actually moved and inspection reports were given some days after the ship on hold instructions, for example in Deals 27 and 47. The inspection reports themselves were vague. There were often sequential ship on hold instructions over the same goods for a number of different customers, so it was far 15 from clear when and how ownership of the goods actually passed.

96. In Deal 12 on 24 March 2006, Abbott had acquired goods from Nobel. Nobel had acquired those goods from Rioni Ltd, whose terms of dealing stated that title would not pass until full payment was made. Nevertheless, Nobel stated to Abbott that it owned the goods free of encumbrances. In fact payment was not made from 20 Abbott to Nobel and from Nobel to Rioni Ltd until 12 May, many weeks after the invoice date. Rioni Ltd could not therefore have passed title to the goods to Nobel and Nobel could not have transferred title to Abbott. Stamill's Deal 45 demonstrated a very similar pattern.

97. The Appellants issued instructions to their UK freight forwarders to ship on 25 hold on the date when an invoice was issued, but goods were often not actually exported for many days, as for example in Deals 10 and 14, but despite this the Appellants issued stock allocation orders to their EU freight forwarders on the invoice date, at which point the goods were still in the UK.

98. Mr Munroe-Birt set out the margins obtained by the Appellants in each of the 30 deals, which ranged between 4 and 6% for most deals, compared to a margin of between 0.09 and 0.24% made by the other participants in the chain. He said that there was no commercial reason for the Appellants, as exporters, to get a higher margin than other suppliers in the chain. Both of the Appellants' suppliers were also in the export market themselves and so could have exported the goods directly, the 35 only commercial reason not to do this was to access the Appellants' capacity to reclaim VAT. All of the Appellants' customers in the EU lacked credibility in some way.

99. Mr Munroe-Birt said that all but one of the Appellants' deals were concluded on a complete back to back basis and always after the 20th of the month, even in 40 circumstances where the number of phones delivered was rather odd (such as Deal 24, for Stamill which traded in 1,483 Nokia phones). There was no evidence of any

complaints, of any returns procedures or any terms and conditions other than the invoices themselves.

100. Goods were often not inspected until 20 or more days after the date of sale and physical delivery was often several weeks after the invoice date. He said that the average time between invoice date and inspection was 21 days.

Financing of the deals

Ms Messham

101. Ms Messham explained that Stamill was initially financed with personal loans from her. Abbott was financed through inter-company loans from Stamill and further commercial financing. She used an FCIB account when her UK account with RBS was closed. FCIB offered real time electronic banking, unlike any other banks were doing at this time. No issues were raised from other banks with the Appellants use of an FCIB account.

102. No one other than her had access to the Appellants' FCIB bank accounts other than when she was on leave. Only trusted members of staff had access to this account and she regularly checked and monitored the payments being made and received.

Mr Mody

103. Mr Mody provided evidence on behalf of HMRC concerning the FCIB accounts of the Appellants and payments which had been traced through those accounts.

104. Mr Mody explained that his research into the FCIB accounts had demonstrated a consistent flow of funds between parties in these transaction chains with many of the participants not making a profit. His research had revealed that the participants (through common directors) had links with a "cell" in Malaga, Spain.

105. Mr Mody's exercise of tracing payments made through FCIB accounts demonstrated for the trades in which the Appellants were involved during 2006 that the flow of funds for each of the 52 disputed deals started and ended with the same entity; Bilgisel Ticaret. The time taken to move the funds through all of the traders in the circular transactions was relatively brief, for example in Deal 1 payments were made between participants with a gap of only three to six minutes and all payments were made within 26 minutes, from start to end. The IP address used by Abbott to make its payments was also used by a number of other participants in the chain, including Abbott's customer, the contra-trader and another conduit. These payments could only have been done either by Ms Messham or by her giving her password to someone else so that they could do the transactions.

106. Mr Mody said that HMRC had not identified the IP address used for all deals, but had identified it for 20 of the 52 deals which had been traced on the Paris server.

107. Mr Mody also demonstrated how payments flowed from the clean chains to the dirty chain and then back into the clean chain in a number of money loops; the same money often being sent around loops more than once to satisfy an invoice amount (for example in Deal 1).

5 108. The FCIB evidence also demonstrated that Abbott consistently underpaid its suppliers; in theory Abbott should always have paid out to its suppliers more than it received from its customers because of having to account for VAT, but this was not the case for Abbott. Abbott underpaid its suppliers by an estimated £6.2 million; suggesting that the deals were not commercial. Similarly Stamill underpaid its 10 suppliers by approximately £4.39 million.

109. In many instances there were discrepancies between the date when invoices were issued by the Appellants and the date when payment was made, with very large time gaps between the invoice dates and payment (for example in Deal 1 the invoice date was March but payment did not happen until May).

15 **Mr Birchfield**

110. Mr Birchfield's evidence related to the FCIB accounts of the six contra-traders involved in these transactions and the FCIB accounts of each of the Appellants. His evidence from the payments identified through the FCIB accounts of each of the contra-traders was that they all followed the same pattern with the export being paid 20 for in a "block of circulating payments":

> *"If a deal is for a consignment worth £6 million, it will be paid for by 10 rapid circuits of payments for approximately £600,000. A later transfer of funds from a parallel deal where the contra trader is acquiring goods for sale to a broker .... will be used to fund the shortfall in receipts from the contra trader's 25 zero –rated export sales to cover the VAT included in the UK purchase in the tax loss chain".*

111. Mr Birchfield also said that there was a considerable use of common computer IP addresses by those participating in the payment chains. He identified one IP 30 address which was used by six UK contra-traders, Export Tech Ltd, Rioni Ltd, Blackstar UK Ltd, H&M UK Trading Ltd, MAK Corporation Ltd and Pan Euro Ventures Ltd.

Mr Mendes

112. Mr Mendes completed the tracing exercises for the Appellants' funds through 35 the FCIB accounts commenced by Mr Mody.

113. Mr Mendes considered a number of fund flows related to invoices issued by both Abbott and Stamill, including Abbott's invoice 053 (for Deal 1). The fund flow related to that invoice on 22 May 2006 involved seven participants through whom

funds flowed twice starting and finishing with the same entity. Both flows of funds occurred in just over thirty minutes and came through the same IP address.

114. Similarly for Stamill invoice 167 (for Deal 11) the fund flow of 26 May 2006 involved seven participants with the total time for the funds to transfer between all participants being 57 minutes. Six of the seven participants in these transactions used the same IP address.

Mr Humphries

115. Mr Humphries supported the approach of Mr Mody and said that links had been established between companies in the chain and that some of the documents produced by the different companies had been done on a single standard template. All of the EU companies had links to three individuals in Malaga who had also been involved with producing false CMRs and customs stamps.

Ms Messham

116. Ms Messham's response to the FCIB evidence was that it was impossible for the Appellants to advance a positive case in relation to this due to their limited knowledge when compared with the detailed tracing exercise undertaken by HMRC.

Mr Corkery

117. Mr Corkery's witness statement explained how the "grey market" in mobile phones operated, consisting of price arbitrage, currency arbitrage and "box breaking" in response to under or over supply in the market. In the context of that market his view was that the Appellants' trading pattern of importing into the UK and then back to the EU had no economic rationale. If either of the Appellants was acting as an intermediary then the margins which they would have been able to achieve would have been much lower than those actually made.

118. If the Appellants were trading in the grey market and involved in price arbitrage, they would have to turn stock around very quickly, whereas in some cases they were taking up to nineteen days before they inspected goods and up to 21 days to export them.

Mr Letherby

119. Mr Letherby provided a report which explained, amongst other things, the allocation of IP addresses and the possible reasons why different transactions done by different legal entities should be done through the same IP address; we were referred to the *Advent Worldwide Distribution Limited v HMRC* ([2014] UKFTT 249 (TC)) decision and it was explained that a common IP address arises if users are accessing the same physical connection, the same gateway or server and gateway or the same proxy server or mobile data connection.

Conclusion

120. Ms Messham described her attitude to her management of the Appellants in these terms "*I prided myself on my professional approach to my business, but more importantly I have high standards in both my business and private life and I would not risk my reputation and livelihood by becoming engaged in fraudulent activities*"

121. Ms Messham described her relationship with HMRC: "*I was open and honest with HMRC at all times. I traded with reputable established suppliers and customers. I set and achieved standards imposed that went beyond those required by HMRC. By implementing a policy of extended verification across the UK market HMRC have closed down my companies*".

HMRC's arguments

122. HMRC made it clear that their primary submission was that the Appellants, through their director, Ms Messham, knew that each of the 52 disputed transactions for the March, April and May VAT months in 2006 were connected with fraud. They argued as a secondary argument that the Appellants through Ms Messham should have known that the transactions were connected with fraud. HMRC accepted that the onus of proof was on them to demonstrate both of these submissions.

123. The 52 transactions carried out by the Appellants involved only 2 suppliers; Nobel and Trade 24/7 and 3 customers; Olympic BV, Essential Trading SRL and Neo Abaco GmbH.

124. The wider MTIC scheme of which HMRC alleged the transactions were a part was made up of 6 contra-traders; Export Tech Ltd, Rioni Ltd, MAK Corporation Ltd t/a Mobile City Communications, H&M UK Trading Limited, Blackstar UK Ltd and Pan Euro Ventures Ltd.

Legal arguments

125. In HMRC's view, any suggestion that EU authorities such as *Bonik* and *Mahaghleben* could be relied on in the face of the Court of Appeal's decision in *Fonecomp* was unsustainable. Neither of the former cases dealt with contra-trading. It was made clear in *Fonecomp* that a lack of detailed knowledge of the fraud in the contra-chain did not mean that the Appellant's transactions could not be treated as connected with fraud. "*He [the taxpayer] simply has to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some transaction to which his fraud is connected*". [Arden LJ at para [51]]

Commercial features

126. HMRC's main case was that the Appellant companies had made very significant profits for doing very little; £3,637,321.20 in total profit for the three periods against turnover of £80,453,228. That level of profit was too good to be true.

127. The Appellants had made a significantly higher margin than other participants in the chain of transactions, because maximising the export price of the goods increased the Appellants' share of the fraudulent profits, being the VAT reclaimed in the UK.

Due diligence

128. Any due diligence which had been done by the Appellants was a front to cover their fraudulent activity. On the basis of *Mobilx*, the fact that due diligence had been carried out was not sufficient to detract from the bigger picture of the Appellants' involvement in fraud.

129. The due diligence done by the Appellants was a box ticking exercise which, if anything, demonstrated actual knowledge of fraud. Had the due diligence been seriously pursued a number of problems would have been identified. The fact that they were not picked up by the Appellants suggested that the due diligence was intended to be a smoke screen behind which the Appellants knew there were fraudulent deals.

Knowledge of fraud

130. Ms Messham had been involved with two companies prior to her involvement with the Appellants which had been involved in MTIC trading; Keybeam and Slimline. She was a director of Slimline and a broker and day to day manager of Keybeam. Ms Messham was interviewed under caution about the fraudulent activities of Keybeam.

131. The circumstances in which both Abbott and Stamill were acquired and set up suggested a connected with fraud from the outset. Abbott was set up in 2004 after Keybeam had ceased trading and Slimline had been compulsorily de-registered in February 2003

132. Ms Messham also had contact with other entities who were involved in MTIC fraud; Mr Fermor who was director of Big Store and IT Fast Track Ltd.

133. Ms Messham's previous dealings with HMRC on behalf of Keybeam made it clear that she was well aware of MTIC fraud in the mobile phone and CPU markets and this had also been made clear in HMRC's letter to Abbott of 1 November 2004 and to Stamill of 15 July 2002.

134. Her partner, Mr Weller was a director of Keybeam and had been convicted of fraud offences. Ms Messham herself had a number of past convictions for dishonesty.

135. There were other indicators of dishonesty and fraud in these deals; the freight forwarder used in the Netherlands, Worldwide Logistics, had been implicated in the production of false CMRs and when visited by the Dutch authorities had not been able to demonstrate that the goods supposedly held in their warehouse existed.

136. Of the customers dealt with by the Appellants; Olympic BV had been compulsorily de-registered in July 2006; Neo Abaco GmbH had been implicated in the production of false CMRs; Essential Trading SRL was under investigation by the French authorities. The insurance documents provided by the Appellants were also invalid, if not fraudulent.

Indicators of fraud

137. The key indicators of fraud from HMRC's perspective were; the Appellants' very high turnover for the relevant periods compared with earlier periods; an un-commercial trading pattern; deals done on a back to back basis for exactly the right quantities of phones; a consistent level of profits through the chain but a higher level of profit for the Appellants as brokers; a small number of suppliers; a lack of inspection of the goods and little detail on invoices from suppliers or to purchasers; a lack of control or due diligence over freight forwarders (e.g. ACS); the existence of false CMRs (Mr Monster in Holland at Worldwide Logistics); fraudulent insurance documents and chaotic deal documents and payment processes.

Challenges to specific deals

138. *Evidence of a connection with the contra-traders*: HMRC submitted detailed evidence from documentary and banking evidence detailing links between the 52 disputed deals and each of the contra-traders. Some detailed aspects of this evidence were challenged by the Appellants in respect of four of the deals, Deals 1, 15, 41 and 51. HMRC responded to each of these challenges before the Tribunal, producing detailed schedules to the Tribunal of the documents available to support the chains of transactions which traced back to the contra-traders.

139. *Evidence of the connection between the contra-traders and a fraudulent tax loss*: The Appellants had made a number of challenges to the detailed evidence provided by HMRC to establish that the contra-traders transactions were linked to a tax loss. In almost all of those cases HMRC had not been able to provide invoices to validate the transactions which had taken place but had been able to provide secondary evidence (purchase orders and freight forwarder documentation).

140. HMRC's position in respect of tracing a tax loss through a contra-trading chain directly to the Appellant was that it was not necessary for them to identify specific

transactions which could be traced to the Appellant. They cited the FTT decision of *Electrical Environmental Services* and the UTT decision in *Eyedial Limited* in support of this position.

141. *Evidence of connection between the tax loss of a defaulter and contra traders*: The Appellants also argued that for Deal 2 with defaulting trader UR Traders there could be no fraudulent tax loss because HMRC had not issued an assessment to that entity. HMRC argued that there was no need to have made an assessment in order to demonstrate loss of VAT. The obligation to account for VAT arose on the making of a taxable supply whether or not an assessment had been issued. HMRC also referred to the decision in *S&I Electronics PLC* in support of this position. (paras [58]– [62]).

FCIB evidence

142. The witness evidence of Mr Mody and others demonstrated that the transactions in which the Appellants were involved were part of a sophisticated and extensive MTIC cell in which funds were circulated through a number of entities, using the same IP address.

143. As suggested by Mr Mody, payments when they were made were made between participants very quickly, in a matter of minutes between all participants.

Appellants' Arguments

144. The Appellants were not represented before the Tribunal but submitted opening submissions prepared by their advisers before they came off the record to which we were asked to give careful consideration in their absence.

Means of knowledge

145. The Appellants argued that they, through Ms Messham had no knowledge of any transactions beyond those carried out with their immediate suppliers and customers. They had no knowledge or means of knowing what was going on with the suppliers' suppliers or their customers' customers.

146. They had no knowledge of any specific fraud and suggested, despite the recent Court of Appeal decision in *Fonecomp*, that HMRC needed to demonstrate that they had specific knowledge of the fraud in the contra-chains in order to demonstrate that they knew or should have known that any of these 52 disputed transactions were connected with fraud.

147. The Appellants had carried out due diligence in accordance with HMRC's guidelines. HMRC had never raised questions with the due diligence carried out or

warned the Appellants that their deals, or their customers or suppliers might be involved in fraud. HMRC had made VAT repayments in respect of the same suppliers and customers for earlier periods.

148. The Appellants dealt in a commercial way, acting as brokers to match demand and supply in this particular market. There was nothing un-commercial about the way in which their deals were done; brokers would not usually hold stock and would not buy other than to the specific order of a client.

149. Ms Messham would not knowingly have dealt with suppliers or customers who were involved with fraud. It was correct that she had worked for a company, Keybeam, which had been involved in fraudulent trading, but she had not been a director of that company and had not been charged with any offences relating to her activities while employed there.

150. It was disproportionate for HMRC to refuse to repay the VAT to these two Appellant companies when other companies had had their VAT re-paid. The companies were being put out of business by HMRC's failure to repay their input VAT.

151. It is accepted by HMRC that there was a legitimate grey market in mobile phone. Fraudsters had penetrated that market by 2006 but the transactions carried out by the Appellants were legitimate commercial transactions.

EU Law: Objective factors for denying right of deduction

152. On the basis of current EU law and the decision in *Mahageben* in particular the right to deduct input VAT is a fundamental right and the Appellants fulfilled the substantive and formal conditions for the right to deduct their input tax for all of the disputed deals. That is not the case for other parties in the chain and it is disproportionate and discriminatory for HMRC to penalise the Appellants for the actions of others in the chain. HMRC must have regard to the circumstances of each case to determine whether those principles had been infringed as made clear in *Kittel*. The resale by a participant in fraud is a taxable transaction not "outwith the scope of VAT" as suggested in *Mobilx*.

153. The Appellants stressed that it is clear that the onus is on HMRC to demonstrate on the basis of objective factors that the Appellants should be refused the right to deduct input tax. The factors cited by HMRC are not relevant objective factors; in particular HMRC have not made clear how the Appellants' business can be objectively differentiated from the international wholesale market in mobile phones.

Contra-trading and the Kittel test

154. HMRC's case is based on their own "contra-trading" construct generated after these deals were carried out. The principle permitting the denial of input tax does not apply in contra-trading cases; the deduction of input tax incurred in one chain of supply from output tax arising in a different chain of supply is not a legal basis for denying input tax deduction. This is made clear in the *Bonik* decision of the ECJ

> " *a taxable person cannot be refused the right of deduction unless it is established on the basis of objective factors that that taxable person............. knew or should have known that, through the acquisition of those goods or services, he was participating in a transaction connected with VAT fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply of those goods or services*"

155. The connection with fraud required in a contra-trading case can only be the deliberate inclusion of the transaction in a VAT return. None of the factors relied on by HMRC are sufficient to establish that either of the Appellants should have known of the connection with fraud, none of those factors were capable of alerting the Appellants to how the contra-traders were completing their VAT returns. The *Fonecomp* decision is wrong in law and an appeal to the Supreme Court is pending.

156. HMRC's tracing exercises were undertaken some time after the Appellants carried out the disputed transactions and they could not possibly have traced the details of those transactions in the way in which HMRC have done. HMRC have not been able to find any evidence of direct communication between the Appellants and any of the other alleged fraudsters. There is no evidence in this case of any third party payments being made by either of the Appellants.

157. HMRC have not argued that the Appellants bought and sold goods at other than at market prices, so they must have made a commercial profit.

Conclusion

158. The Appellants neither knew nor had the means to know that the disputed transactions were connected with fraud. The Appellants' transactions were not contrived, the Appellants had a genuine intention to trade and the transactions were legitimate. The Appellants did not have the means to discover and know of a connection with fraud. There are innocent explanations for the position the Appellants found themselves in in 2006 which are consistent with a lack of knowledge of fraud.

Detailed objections to HMRC's case

159. The Appellants provided a schedule of transactions for which they said HMRC had not proved the connection with fraud due to missing documents or missing invoices. They provided a separate schedule of transactions for which they said there was no established link with a fraudulent tax loss due to missing invoices. In some of

the transactions HMRC had not issued assessments and therefore the Appellants said there could be no loss to HMRC.

Findings of Fact

5 160. On the basis of the evidence heard and considered the Tribunal has made these findings of fact:

161. Ms Messham had previously been involved with companies including Keybeam which had been involved in MTIC fraud in the UK and was aware of how MTIC fraud operated.

10 162. Many of the disputed deals carried out by Abbott and Stamill were from common IP addresses which were shared with other participants in the chains of transactions.

163. All of the disputed deals carried out by Abbott and Stamill were carried out in a short time frame, on a back to back basis and with no evidence of deal failures or 15 returned stock and no evidence of commercial negotiations over price or quantity of goods to be delivered.

164. Both Appellants significantly increased their profits up to and including the periods during which the disputed deals were entered into and made a high profit margin on their deals compared with others in the buying and selling chain, with little 20 staffing or other resources.

165. IMEI numbers and box numbers were not recorded for any of the goods traded by either of the Appellants.

166. The Appellants' trading patterns did not demonstrate any added value of the kind associated with grey market trading nor did they reflect patterns of dealing 25 consistent with grey market trading.

167. The time when ownership of the goods changed hands was not clearly documented for any of the disputed deals.

168. The goods were not insured with a reputable insurer on standard market terms.

169. Due diligence carried out on customers, suppliers and others involved in the 30 transactions was formulaic and cursory.

170. The Appellants on a number of occasions did not pay the full amount due by them to their suppliers.

171. The Appellants did undertake Redhill clearances on suppliers but these were not done immediately before the disputed deals were carried out.

Decision

The decision in Fonecomp

5 172. The Appellants' legal challenge to HMRC's argument concerning the applicability of the *Kittel* approach to HMRC's "construct" of contra-trading transactions was dealt with comprehensively in the *Fonecomp* decision which held that the Kittel principle could be applied even if, as in a contra-trading case such as this, the VAT default is in a chain which is separate from the supply chain to which 10 the Appellants' input VAT claim relates. It is not necessary that the taxpayer should know the details of the fraud being perpetrated and certainly not necessary for the taxpayer to have knowledge of the VAT return of the defaulter. Arden LJ in that case referred to the decision in *Universal Enterprises (EU) Ltd* which stated that:

> "*The argument that a trader in a clean chain cannot be effected by anything* 15 *that happens in a dirty chain is in my judgment wholly misconceived...... the Appellant's argument necessarily treats "clean" as synonymous with "innocent" but a clean chain in cases of this kind – that is one in which each of the traders correctly accounts for VAT – is not innocent; it is an integral part of the fraudulent scheme". para [22]*

20 173. On that basis it is not necessary for HMRC to allocate a particular tax loss to a specific defaulting trader, it is only necessary, as stated in *Kittel* that *"a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with the fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether* 25 *or not he profited by the re-sale of the goods*" or as restated in *Fonecomp* "*He has simply to know, or have the means of knowing that fraud has occurred, or will occur, at some point in some transaction to which his fraud is connected".*

174. The Appellants made much of the fact that they, unlike HMRC, were not in a position to establish the connections between their transactions, the contra-traders and 30 the defaulters, but it is not necessary to the state of mind at which the *Kittel* test is directed that the Appellants should know at the time when they enter into their transactions how their deals are connected, it is only necessary that that connection can be demonstrated by HMRC as an objective fact, as recently made clear in the *S & I Electronics* decision.

35

Detailed challenges rebutted

175. In the absence of the Appellants the Tribunal spent some time considering each of the detailed challenges made by the Appellants for transaction chains in which they

claimed that HMRC had either not proved a tax loss or not proved a connection with a contra- trader.

176. *Proof of connection with contra-trader*: In each of these cases the Tribunal concluded that while the primary evidence might not have been provided by HMRC in the form of invoices or documents there was sufficient secondary evidence in each case to support the deal chains proposed by HMRC. For example, Deal 41 (invoice 076) although no invoice between Rioni Ltd and Nobel was provided, we did see the purchase order from Nobel to Rioni Ltd and an allocation note for the freight forwarders. In those circumstances our view is that this is sufficient evidence to demonstrate the chain of transactions and the Appellants' part in them without the need for the production of the actual purchase invoice.

177. *Connection between contra-trader and tax loss*: HMRC accepted that they did not have sufficient documentation to show that two of H&M UK Trading Ltd's deals and three of MAK Corporation Ltd's deals traced to a defaulting trader but referred us to the surrounding circumstances and asked that we infer from the other deals undertaken by the entities that these deals would have followed the same pattern. While it is tempting to accept in cases such as this that patterns of previous dealing are good evidence of what was likely to have been done for the transactions for which evidence has not been produced, we do not accept HMRC's submissions on this point and make no specific findings in respect of these deals, noting the fact that the onus is on HMRC to demonstrate the connection with fraud.

178. However, it was made clear in the UT decision of *Eyedial* "*it is not necessary for the tribunal to verify every transaction of the contra-trader and every dirty chain involving the contra-trader in the relevant period*", it can rely on circumstantial evidence and sample transactions to conclude that other transactions undertaken by a particular trader are connected with fraud without having to prove the details of each particular transaction, and it is on that basis that we have concluded that HMRC have demonstrated, on the balance of probabilities, that a connection existed between the tax loss and the contra-traders in these transactions.

179. *Evidence of tax loss by defaulting trader*: We do not accept the Appellants' position that unless an assessment has been issued HMRC cannot claim that there has been a loss of tax and therefore deny input tax. We agree with HMRC that it is not the issuing of an assessment which creates a VAT debt (or loss) to the crown, but the existence of taxable supplies in respect of which no, or the incorrect amount, of VAT has been paid.

180. Having rejected each of the Appellants' arguments which go to the details of specific deals, the Tribunal has concluded that HMRC have demonstrated on the balance of probabilities that each of the Appellants' disputed deals were connected to a fraudulent tax loss.

181. The Tribunal has concentrated on what it considers to be the main point at issue, whether the Appellants, through their director Ms Messham knew or should have known that each of these 52 disputed transactions were connected with fraud.

Knew or should have known – the Kittel test

Indicators of fraud

182. Between them these two Appellants were involved in 52 transactions over a three month period with a small number of counterparties, only two different suppliers and three different customers. We do not consider that it is necessary for HMRC to prove that Ms Messham knew anything about others in the chain of fraudulent deals, including the identity and actions of the contra-traders, only that there were sufficient indicators in these deals to put a normal business person, including one who understood the grey market in mobile phones, on notice that the deals were not commercial; a number of those indicators were present here;

(1) the small number of counterparties,

(2) the profit margins,

(3) the lack of legal certainty of ownership,

(4) a lack of concern for physical location, state or identity of goods,

(5) a lack of valid insurance,

(6) the back to back trading pattern.

183. In more detail:

(1) Counterparties: The repeated appearance of the same counterparties, two suppliers and three customers over a three month period does not seem to us to be consistent with usual patterns of legitimate trading in high volume, high value goods for which the market was extensive and liquid. In contrast, the two Appellants between them dealt only with two suppliers Nobel and Trade 24/7 and three customers to generate a joint net turnover of £80,435,228. Nor does it seem to us to be in line with patterns of trading in the "grey market" where short term arbitrage opportunities are being exploited as explained by Mr Corkery; it does not seem likely that this kind of arbitrage based dealing would produce such a small set of counterparties, indeed consistent dealing with the same counterparties is more likely to diminish any such opportunities.

(2) *Profit margins*: Both Appellants achieved what can only be described as a very significant increase in turnover and profit for these periods; £20 million per month for Abbott and up to £17 million for Stamill. For this level of turnover, one would have expected significant risk and resources to be committed to the transactions. In fact, the pattern of the Appellants' trading does not suggest that any value is being added by them. As HMRC point out, in some cases the Appellants' supplier appears to have its own UK exporting entity which could have carried out the same role as the Appellants with no loss of profit to the group, but nevertheless it is the Appellants which are used to do the deal.

Neither did Ms Messham appear to rely on significant staffing to support these deals; we were told that she was operating from an office in her home on a housing estate. In contrast to the risk and resources employed by the Appellants, the level of profit which they derived from these deals is high. It is also higher than the margins made by other participants in the chains of which the deals were part and relatively consistent.

(3) *Lack of legal certainty*: In some instances the Appellants did not make payment of the full amount due to their suppliers. It is unlikely in normal commercial transactions that suppliers would be prepared to accept non-receipt of the full sums due to them. There was also considerable lack of clarity about when ownership to the goods passed and who was responsible for them at certain points in the transaction chain, of which the Appellants were aware.

(4) *Lack of concern for the goods*: There was a lack of clear descriptions of the goods which were being bought and sold which suggests to us that the deals were not negotiated in the way that standard commercial transactions would be. Although Ms Messham told us that the details and specifications of the goods were settled by telephone, we saw no evidence of this. Equally, despite Ms Messham's statements, there we saw no evidence in any of the inspection reports of any boxes being opened.

(5) *Lack of insurance*: The failure of the Appellants to take out insurance over the goods at least until a meeting with HMRC suggested that this might be required is not indicative of normal commercial actions or of a business person taking a responsible view of the risks involved in these transactions.

(6) *Trading pattern*: The trading pattern of the Appellants was almost entirely "back to back" with sales matching purchases exactly and no stock held by or returned to the Appellant, even when the number of phones comprised in a single deal was rather odd, such as the 1,483 Nokia 8800 phones bought and sold by Stamill in Deal 24 (Invoice 174). Dealing with high volume, high value goods of this nature it would not seem likely in a normal commercial context that there was never any shortfall or oversupply of the goods to or from suppliers or purchasers.

Wider context of these transactions

184. The details of each particular transaction might lead us to the conclusion that the Appellants should have known, because of their unusual character, that the deals were fraudulent. If we add to that Ms Messham's knowledge of this market and her previous experience with HMRC in fraudulent investigations, we can only conclude that the Appellants were prepared to act as they did because they knew each of these deals was fraudulent. Our view is that any normal commercially minded business person having had the experience which Ms Messham had had of what she described as the "murky world" of mobile phone fraud would have exercised a considerable

amount of caution in entering into these deals, if indeed they would have entered these deals at all.

185. We know that Ms Messham was involved with Keybeam, that HMRC supervised that company and that there was a criminal investigation into Keybeam for MTIC trading. We know that Ms Messham had significant involvement with that company. Although the extent of her day to day involvement is disputed, it was certainly with her that HMRC mainly dealt. We also know that Ms Messham knew about the "murky world" of mobile phones and that she had contacts with Mr Fermor of the Big Store Limited who were themselves involved in MTIC fraud. On the basis of this evidence, which was not disputed by the Appellants, it is impossible to conclude that Ms Messham, and through her the Appellants, were not aware in general of the scale of potential fraud in the mobile phone and CPU markets, and in particular, of the form that that fraud tended to take and that the Appellants' deals demonstrated features which meant that they were almost certain to be fraudulent.

Due diligence

186. Ms Messham stressed that she took her commercial obligations seriously and did carry out due diligence on her suppliers, purchasers and others involved in these transactions. Our view of the due diligence which we saw is that while some was undertaken, it lacked any follow up and appeared in most cases to be only a token gesture.

187. It is hard to explain why anyone really concerned about fraud would have made such a partial effort at due diligence, especially someone with Ms Messham's knowledge of the issues in this market. There are some notable cases in which the due diligence produced information which should certainly have raised concerns and prompted more questions, but in fact nothing was done. The Veracis reports relied on by the Appellants were themselves less than comprehensive and on occasion the level of information provided on the standard questionnaires was derisory suggesting that the exercise was not being taken seriously by those who were either completing or examining the documents.

188. For example we saw the Veracis questionnaire completed by ACS, the UK freight forwarder which gave very brief answers to the standard questions and included the notable statement that its asset base was nil. We also saw the same form which had been completed by SPF describing its asset base as nil in slightly more colourful language and referring to a £22 water bill as supporting evidence. Nevertheless this did not provoke any response from either Mr Plowman or Ms Messham, suggesting that either they did not review the documents in any detail or if they did, were not concerned with what was stated or not stated on them.

189. In other cases, particularly for the EU freight forwarders no due diligence was done at all.

190. In our view this is a case in which due diligence is being used as a smoke screen to hide the knowledge of Ms Messham that each of these 52 transactions were actually part of extensive and well organised fraud.

5 *Reliance on and relationship with HMRC*

191. Part of Ms Messham's argument was that HMRC had condoned her actions. However, in our view it is not HMRC's role to point out potential fraud to taxpayers; the onus is on taxpayers to ensure that they do not become involved. Ms Messham in particular should have been aware of this given her earlier experience with fraudulent
10 trading companies. Equally earlier repayments do not mean approval by HMRC; they were paid on a without prejudice basis.

192. We cannot accept Ms Messham's statements that her relationship with HMRC was generally one of co-operation. The best evidence that this is not the case is the description given by Mr Monroe-Birt of his unannounced visit to Keybeam's
15 premises on 2 September 2003 (admittedly sometime before the disputed deals were carried out) described by him; "*there were frantic calls and shouting up to whoever she could – whoever's attention she could attract on the first floor there to presumably stop me observing something she didn't want me to see*". Those are not the actions of someone who is dealing openly and honestly with HMRC as Ms
20 Messham asks us to believe.

Conclusion

193. Ms Messham needs to demonstrate that despite the indicators of fraud demonstrated by these deals, despite her knowledge and experience of fraud in this
25 market, despite her close links with those involved with fraud in this market, she was an innocent party who had no basis to know that the deals in which the Appellants were involved were fraudulent. If that is correct, she was an island of innocence surrounded by a sea of fraud. HMRC said that the evidence of knowledge of fraud was particularly strong in this case and we agree. It seems to us almost inconceivable
30 that she did not understand the nature of the business that she was dealing in

194. Ms Messham relied on the due diligence which was undertaken by the Appellants as evidence that they had no knowledge of fraud; our view is that this might alleviate suspicion on a deal by deal basis, but could not do so by reference to the whole picture. Even on deal by deal basis, our view is that any due diligence was
35 not seriously pursued, perhaps best illustrated by what might be described as the rather casual responses made to the Veracis due diligence questionnaires.

195. Someone without Ms Messham's experience might have questioned some of the unusual aspects of these deals; someone with Ms Messham's experience must have known that those aspects of the deals could only mean that they were connected with
40 fraud.

196. Our view is that there can be little doubt that Ms Messham knew that the deals in which these Appellants were involved were fraudulent.

Disproportionality and discrimination

197. The Tribunal does not consider that there is any real basis on which Appellants in the position of Abbott and Stamill can suggest that HMRC's decision to deny them the right to deduct input tax is disproportionate. It is clear from decisions in the EU courts that while VAT is based on the principal of neutrality on which the right to deduct input tax by a taxable person is based, national courts can restrict that right, if as here, the transactions in question are known, or should have been known, by the trader to be connected with fraudulent transactions.

198. The Appellants also seek to argue that in denying their input tax for these periods and not denying input tax repayments to other traders involved in the same transactions HMRC have discriminated against Abbott and Stamill. Any question of how HMRC have chosen to apply their discretion in penalising one taxpayer as against another relates to HMRC's administrative function and as such is outside the remit of this Tribunal, as made clear in recent decisions such as HMRC v *Abdul Noor* ([2013] UKUT 071 (TCC). The Appellants have not specified in any detail why they believe that these arguments should be considered by this Tribunal and the Tribunal has concluded that these arguments are outside its remit.

199. For these reasons this appeal is dismissed and HMRC's decision to deny the Appellants' right to deduct input tax for each of the disputed deals in confirmed.

200. 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.

RACHEL SHORT
TRIBUNAL JUDGE

RELEASE DATE: 2 MARCH 2016

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Schedule of Deals

Appellant & Deal number	Date	Goods	Bought from	Sold to	Profit margin %	
1. Abbott	20.03.2006	Sony Ericsson W900i	Trade 24/7 Ltd	Neo Abaco GMBH	3.99	
2. Abbott	21.03.2006	Nokia 8800	Trade 24/7 Ltd	Olympic Europe BV	3.99	
3. Abbott	21.03.2006	Samsung D600	Nobel Wireless	Neo Abaco GMBH	4.00	
4. Abbott	22.03.2006	Nokia N70	Nobel Wireless	Essential Trading	4.00	
5. Abbott	22.03.2006	Nokia 5100	Trade 24/7 Ltd	Essential Trading	4.06	
6. Abbott	23.03.2006	Nokia N91	Nobel Wireless	Neo Abaco GMBH	4.00	
7. Abbott	23.03.2006	Nokia 7380	Trade 24/7 Ltd	Essential Trading	3.99	
8a Abbott	23.03.2006	Nokia 1600	Nobel Wireless	Neo Abaco GMBH	4.04	
8b. Abbott	23.03.2006	Nokia 1600	Nobel Wireless	Olympic Europe BV	4.81	
9. Stamill	23.03.2006	Motorola Pebble	Nobel Wireless	Olympic Europe BV	4.00	
10. Stamill	23.03.2006	Intel Pentium SL7PM	Nobel Wireless	Neo Abaco GMBH	4.00	
11. Stamill	23.03.2006	Nokia N91	Trade 24/7 Ltd	Olympic Europe BV	4.00	
12. Abbott	24.03.2006	Intel Pentium 4	Nobel Wireless	Neo Abaco	3.99	

		SL7Z9		GMBH		
13. Abbott	24.03.2006	Intel Pentium 4 SL7Z9	Nobel Wireless	Essential Trading	4.00	
14. Stamill	24.03.2006	Nokia 6681	Trade 24/7 Ltd	Essential Trading	4.00	
15a. Abbott	28.03.2006	Sony Ericsson W800i	Trade 24/7 Ltd	Essential Trading	4.00	
15b. Abbott	28.03.2006	Sony Ericsson W800i	Trade 24/7 Ltd	Neo Abaco GMBH	3.95	
15c. Abbott	28.03.2006	Sony Ericsson W800i	Trade 24/7 Ltd	Olympic Europe BV	4.09	
16. Abbott	28.03.2006	Nokia 3120	Trade 24/7 Ltd	Essential Trading	4.13	
17a. Abbott	28.03.2006	Motorola V3i Black	Nobel Wireless	Olympic Europe BV	4.02	
17b. Abbott	28.03.2006	Motorola V3i Black	Nobel Wireless	Neo Abaco GMBH	4.07	
18. Abbott	28.03.2006	Motorola V3 Pink	Nobel Wireless	Olympic Europe BV	4.00	
19. Stamill	28.03.2006	Nokia 6230i	Nobel Wireless	Essential Trading	4.00	
20. Stamill	28.03.2006	Nokia 3250	Trade 24/7 Ltd	Neo Abaco GMBH	4.00	
21. Stamill	28.03.2006	Nokia 3230	Nobel Wireless	Essential Trading	4.00	
22. Stamill	28.03.2006	Nokia 8801	Nobel Wireless	Olympic Europe BV	4.00	
23. Stamill	29.03.2006	OEM 1GB A Speed DDRRAM	Trade 24/7 Ltd	Olympic Europe BV	4.00	
24. Stamill	29.03.2006	Nokia 8800	Trade 24/7 Ltd	Neo Abaco GMBH	3.99	
25. Abbott	31.03.2006	2GB A-Spec DDRRAM	Nobel Wireless	Neo Abaco GMBH	4.00	
26. Abbott	21.04.2006	Sony Ericsson	Nobel Wireless	Olympic Europe	5.00	

		W900i		BV		
27. Abbott	21.04.2006	Sony Ericsson K750i	Nobel Wireless	Neo Abaco GMBH	5.00	
28. Abbott	21.04.2006	Sony Ericsson K750i	Nobel Wireless	Essential Trading	6.00	
29. Abbott	21.04.2006	Nokia 8800	Trade 24/7 Ltd	Neo Abaco GMBH	6.00	
30. Stamill	21.04.2006	Sony Ericsson W800i	Nobel Wireless	Neo Abaco GMBH	5.03	
31. Stamill	21.04.2006	Nokia 8800	Trade 24/7 Ltd	Neo Abaco GMBH	5.00	
32. Stamill	24.04.2006	Intel Pentium 4 SL7Z9	Nobel Wireless	Olympic Europe BV	5.98	
33.Abbott	25.04.2006	Nokia N91	Nobel Wireless	Neo Abaco GMBH	6.00	
34. Abbott	25.04.2006	Nokia 9300i	Nobel Wireless	Essential Trading	5.00	
35. Abbott	25.04.2006	Nokia 6630	Nobel Wireless	Neo Abaco GMBH	5.98	
36. Stamill	25.04.2006	Intel P4 3.0Ghz 2MB	Trade 24/7 Ltd	Olympic Europe BV	4.52	
37. Stamill	25.04.2006	Motorola V3i	Nobel Wireless	Essential Trading	5.99	
38. Stamill	25.04.2006	Motorola Razor V3i	Trade 24/7 Ltd	Essential Trading	5.80	
39. Stamill	25.04.2006	Nokia 8801	Trade 24/7 Ltd	Neo Abaco GMBH	6.00	
40. Abbott	26.04.2006	Sony Ericsson W800i	Nobel Wireless	Olympic Europe BV	5.99	
41. Abbott	26.04.2006	Nokia 6680	Nobel Wireless	Essential Trading	5.00	
42. Stamill	26.04.2006	Intel Pentium 4 SL7Z9	Trade 24/7 Ltd	Neo Abaco GMBH	4.82	
43. Stamill	26.04.2006	Intel 640 Retail	Nobel Wireless	Olympic Europe	6.02	

		Pack		BV		
44. Abbott	27.04.2006	Nokia 7380	Trade 24/7 Ltd	Neo Abaco GMBH	5.02	
45. Stamill	27.04.2006	Nokia N90	Trade 24/7 Ltd	Essential Trading	5.00	
46. Abbott	28.04.2006	Nokia N70	Trade 24/7 Ltd	Essential Trading	5.00	
47. Abbott	28.04.2006	Motorola Pebble	Trade 24/7 Ltd	Neo Abaco GMBH	5.87	
48. Abbott	28.04.2006	Intel Pentium 4 Processor	Trade 24/7 Ltd	Essential Trading	5.00	
49.Stamill	28.04.2006	Nokia 7610	Nobel Wireless	Olympic Europe BV	5.00	
50. Stamill	28.04.2006	Samsung D500	Nobel Wireless	Essential Trading	5.97	
51. Abbott	30.05.2006	Samsung D800	Trade 24/7 Ltd	Neo Abaco GMBH	4.44	
52. Stamill	30.05.2006	Nokia 8800	Trade 24/7 Ltd	Neo Abaco GMBH	3.91	