TC08057

VALUE ADDED TAX – input tax deductibility – restriction of right to deduct under principles in Kittel *– appellant's purchases of printer consumables were connected with fraudulent VAT evasion – did the appellant know the purchases were so connected? – held: no – should it have known? – held: no – appeal allowed*

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal numbers: TC/2018/00978, TC/2019/04325

BETWEEN

DMC BUSINESS MACHINES PLC **Appellant**

-and-

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

TRIBUNAL: JUDGE ZACHARY CITRON
MR IAN ABRAMS

The hearing took place on 8-11, 14-16 and 18 September 2020 (all dates inclusive). The hearing was held on the Tribunal's video hearing platform. A face to face hearing was not held because of public health issues arising from the coronavirus pandemic, as well as the fact that all parties had satisfactory access to the Tribunal's video hearing platform. The documents to which the Tribunal was referred are described in the decision below.

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

David Scorey QC and Luke Tattersall, counsel, instructed by Keystone Law, for the Appellant

Howard Watkinson and Joshua Carey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal was about whether the appellant ("DMC") knew, or should have known, that hundreds of purchases of printer ink cartridges and toner ("printer consumables") by it, costing over £13 million, were connected with the fraudulent evasion of VAT.

2. In this decision, the terms "input tax", "output tax" and "VAT credit" have the meanings they have in the Value Added Tax Act 1994.

BACKGROUND TO THE APPEAL

3. HMRC notified DMC on 6 September 2017 that they were denying it the right to deduct input tax of £2,196,418 claimed on 802 purchases of printer consumables in VAT periods 11/14 – 08/16 inclusive, on the grounds that the purchases were connected with the fraudulent evasion of VAT, and that DMC knew, or should have known, of such a connection. The value of the purchases (net of VAT) was £13,178,508.

4. The denial of the right to deduct led to HMRC assessing DMC for £1,114,962.58 for VAT periods 11/14 – 02/16 and adjusting the VAT credit claimed by DMC on its VAT returns for the 05/16 and 08/16 periods by £1,081,455.42. A notice of assessment for £1,114,962.58 was issued on 2 August 2017.

5. DMC appealed by way of a notice of appeal dated 17 January 2018.

6. HMRC later realised that the assessment amount for £361,126 for the 02/16 VAT period was incorrectly allocated to the 02/15 VAT period. On 14 March 2019 HMRC therefore amended the original incorrect assessment to reallocate the sum of £361,126 to the 02/16 VAT period. DMC appealed by way of a notice of appeal dated 30 April 2019. At the hearing DMC withdrew one of its grounds for this appeal (being that the assessment was made out of time.)

THE HEARING

7. There were a number of interruptions to the video hearing, mostly due to wi-fi connectivity being lost; in each case, however connectivity was restored after a relatively short period (or upon resumption of the hearing after a break or the end of the day). Overall, the hearing was completed comfortably within the time allocated. The Tribunal invited comments on the video format in closing submissions and the point was made by the appellant's counsel that the format made it somewhat more difficult to communicate by "body language"; for example, it was more difficult for cross examining counsel to indicate to a witness that their answer was going on too long or was off the point. HMRC's counsel commented that whilst the hearing was fair, it would have been more "effective and efficient" if held face to face.

8. Overall the Tribunal was satisfied that the hearing had been fairly held.

EVIDENCE

9. We had three pdf court bundles and a supplementary bundle, amounting to 7,495 pdf pages. This contained (inter alia)

    (1) witness statements of five HMRC officers:

        (a) Elizabeth Agyekum-Saki

        (b) Bola Omola

        (c) Gerard Dixon

(d) Shaheen Rehman

(e) Kirsten Forrester

(2) witness statements of five employees and/or directors of DMC at relevant times:

(a) Damian Kelly, head of the Distribution business, a division of DMC

(b) Aziz Talati, sales executive in the Distribution business

(c) Jonathan Hill, chief executive officer and a director and major shareholder

(d) Steve Cook, a director from May 2015 to May 2018 and finance director

(e) Paul Bruce, logistics manager

Of these, only Mr Hill and Mr Bruce were still employees of, or otherwise connected with, DMC (or its successor (from 2018) in relation to the Distribution business, Canotec London Ltd) at the time of the hearing.

(3) a witness statement of Mr Steven Hastings, a sales executive with experience working for manufacturers, distributors and traders in the printer consumables industry.

(4) "deal packs" including invoices (i) from the suppliers in respect of the Purchases (as defined below) (ii) from DMC in respect of on-sales of Goods (as defined below) to customers.

10. The following witnesses gave oral evidence and were cross examined:

(1) Ms Agyekum-Saki

(2) Mr Kelly

(3) Mr Cook

(4) Mr Talati

(5) Mr Hill

(6) Mr Bruce

11. During the course of the hearing we admitted into evidence a supplementary bundle of 20 pdf pages relating to CE Logistics Ltd.

AGREED MATTERS

12. It was agreed in this case that

(1) there had been a VAT loss resulting from fraudulent evasion:

(2) the Purchases (as defined below) were connected with that fraudulent evasion;

(3) the sole issue was therefore whether DMC knew, or should it have known, that the Purchases were connected with fraudulent evasion of VAT;

(4) it was for HMRC to prove these matters, on the balance of probabilities; and

(5) knowledge by Mr Talati was attributable to DMC.

INITIAL FINDINGS OF FACT

13. In this section we find facts based on evidence that was clear or uncontested (or both). Later in the decision, after outlining the law and the parties' arguments, we shall make

"further" findings of fact based on evidence that was less clear, or contested (or both) – and give more extended reasons for the findings.

The Purchases

14. This appeal concerned the following supplies (the "**Purchases**") of printer consumables (the "**Goods**") to DMC:

(1) 28 purchases from Pricemo Ltd ("**Pricemo**") between 14 May 2012 and 20 January 2015, totalling about £1.7 million (net of VAT). The Pricemo Purchases took place in two periods: May to September 2012; and then October 2014 to January 2015.

(2) 678 purchases from Blue Arrow Trading Ltd ("**Blue Arrow**") between 3 February 2015 and 10 August 2016, totalling about £3.8 million (net of VAT).

(3) 96 purchases from Vision Sourcing Ltd ("**Vision**") between 30 April 2015 and 28 July 2016, totalling about £9.1 million (net of VAT)

15. When we refer in this decision to Goods or Purchases of a particular supplier, we use the phrase "**Pricemo Goods**", "**Pricemo Purchases**" etc.

The fraudulent evasion of VAT with which the Purchases were connected

16. Vision purchased the Vision Goods from Bryanswood Associates Ltd ("**Bryanswood**").

17. Bryanswood, Pricemo and Blue Arrow fraudulently evaded VAT by making supplies of the Goods (to Vision in Bryanswood's case, and to DMC in the cases of Pricemo and Blue Arrow) without accounting for output tax on the supplies.

DMC's onward sales of the Goods

18. The customers to which DMC on-sold the Pricemo Goods in the first period (May – September 2012) were largely non-UK companies in the EU. The customers to which DMC on-sold the Pricemo Goods in the second period (October 2014 - January 2015) (for €327,000 – roughly 20% of the £1.7 million total Pricemo Purchases) were largely companies in the UK.

19. DMC on-sold Blue Arrow Goods of £1.58 million to Item International Handel GmbH ("**Item**"), a customer in Austria. DMC on-sold Blue Arrow goods of £1.6m to Printberry Distribution GmbH ("**Printberry**"), another customer in Austria. DMC on-sold Blue Arrow Goods to other non-UK EU customers (totalling just under €350,000). Thus, around €3.5m (or 78%) of the £3.89m of Blue Arrow Goods were on-sold to non-UK EU customers – and the remainder to UK customers.

20. DMC on-sold about 90% of the Vision Goods to Item, and the remainder to Printberry and Al Noori Computers & Stationery (LLC) – a DMC customer in the UAE.

21. The onward sale of Goods to non-UK EU companies generally took place within days of the Purchase. Goods sold to UK companies were generally taken into "stock" and so it was not possible to say exactly when such Goods were on-sold (or to which particular UK buyer).

DMC

22. DMC was a privately owned, medium sized company, incorporated in 1990. Mr Hill, one of the founders, was the chief executive officer throughout the period relevant to this appeal. Mr Cook joined DMC as the finance controller in January 2012 and became finance director from May 2015. He reported to Mr Hill. DMC had about 105 employees. Its main office was in Croydon, where it had a warehouse.

23. DMC operated through the following business divisions:

(1) the "Direct" business supplied Canon copiers to customers – DMC was an authorised Canon reseller;

(2) The "Service" business supplied maintenance services to customers of the Direct business;

(3) an "IT and Telecommunications" business operated from the year ended 31 March 2015; and

(4) the "Distribution" business traded in printer consumables. The Purchases and on-sales of Goods were made by the Distribution business.

24. The scale of DMC's operations, and the relative size of its divisions, can be seen from the tables below, summarising sales and gross profit, in total and per business division, between the year ended February 2012 (the first year for which DMC could produce specific data for the Distribution business) and the year ended March 2018:

Sales (£ millions)

Year ended	DMC total	Distribution		Service	Direct	IT
			% of DMC total			
February 2012	29.4	21.8	74	4.2	3.4	
February 2013	22.0	14.5	66	4.1	3.4	
March 2014	22.1	15.6	71	4.1	2.4	
March 2015	33.0	18.0	55	7.9	6.9	0.2
March 2016	39.2	22.7	58	9.6	6.5	0.4
March 2017	38.9	21.6	56	10.1	6.0	1.1
March 2018	38.7	18.4	47	10.8	7.5	2.1

Gross profit (£ millions)

Year ended	DMC total	Distribution		Service	Direct	IT
			% of DMC total			
February 2012	5.6	2.2	39	2.3	1.1	
February 2013	5.0	1.3	27	2.4	1.2	
March 2014	4.7	1.6	33	2.2	0.8	
March 2015	7.7	1.7	22	4.1	1.8	0.0
March 2016	10.6	2.4	22	5.3	2.6	0.2
March 2017	11.1	2.2	19	5.8	2.5	0.6
March 2018	13.2	1.5	12	8.0	2.5	1.2

25. DMC was in financial good health during the period relevant to this appeal: its net current assets (as a group) as at 31 March 2014-16 were just in excess of £2 million, £3 million and £4 million respectively.

26. As further context to the Purchases and on-sales of the Goods, DMC calculated its gross profit from those transactions relative to the company as a whole as follows (based on DMC's estimation of its average mark-up on the Goods being 4-6%):

Total figures for years ending 31 March 2015-2017	**Supplier**	**Purchases (£m)**	**Estimated gross profit (£000)**			
Margin			**4%**	**5%**	**6%**	
	Vision	7.6	306	382	459	
	Blue Arrow	3.4	139	174	209	
	Pricemo	0.01	5	7	8	
	Total	11.2	450	563	675	
Total DMC gross profit (£m)						29
% of DMC gross profit			1.53	1.91	2.29	

27. In 2018 (i.e. after the period relevant to this appeal), the Distribution business was transferred from DMC to a related company, Canotec London Ltd, in anticipation of the sale of DMC to third party investors, Lyceum Capital, later that year.

Further details about the Distribution business

28. The Distribution business was headed by Mr Kelly, who had built it up from when he was hired by DMC in the late 1990s. Mr Kelly reported to Mr Hill.

29. Between January 2012 and August 2018 the Distribution business bought from 215 suppliers and sold to 1,315 customers. Of DMC's purchases from its ten largest suppliers in the five years ending 31 March 2014 to 2018 inclusive, Vision made up 9% of those purchases by cost of purchase, and Blue Arrow and Pricemo together made up 4%. The largest single supplier in those years was CE Logistics Ltd, making up nearly a quarter of the purchases. In those same five years, Item made up 6% of the sales to DMC's ten largest customers (and was the largest single customer), and Printberry 1%.

30. The strategic report in DMC's accounts for the year ended 31 March 2016 (signed by Mr Hill in September 2016) said the following in relation to the Distribution division:

(1) the division's business "spans across the European market and despite the economic challenges this entails, underlying margins and trading activity have been maintained"

(2) all debts within that division are insured (representing over 70% of DMC's trade debtors)

Similar statements appear in the accounts for the two previous years (those ended 31 March 2014 and 2015).

31. The Distribution business' drop in sales after the year ended February 2012 was due to two of its suppliers losing long running deals. The directors' report in DMC's accounts for the year ended February 2013 said that the Distribution business

> "had seen a considerable increase in European trade both in terms of sales and purchasing. Although all three divisions have seen solid growth in recent years, a significant proportion of

> the growth in turnover in the year ending 2012 was achieved from distribution opportunities that the directors predicted would not be replicated in the current financial year. The directors are satisfied with the results on the basis that the current year turnover is in line with that achieved in 2011 and remain committed to reinvesting profits to fund future growth."

32. The Distribution business had a staff of around 14: a purchasing team, sellers, administrative staff and the warehouse manager and operatives. There were three experienced traders (although one left in 2015), including Mr Talati.

33. Mr Bruce and the warehouse operatives on his Logistics team checked all goods delivered by suppliers to the warehouse for the Distribution business. Consignments were opened and broken down into the boxed products. Checks were made as to the quantity and quality of goods delivered by suppliers (including checking that they were not counterfeit), expiry dates, product codes, and the integrity and suitability of the packaging.

34. For transactions over £50,000, the Distribution business needed authorisation from Mr Cook or Mr Hill to proceed.

Mr Talati

35. Mr Talati managed the Vision Purchases and on-sales. Mr Talati also managed the Pricemo and Blue Arrow Purchases and on-sales, where the Goods were used for the "trading/export" side of the business (as opposed to the "UK" side, which involved Goods going into "stock").

36. Mr Talati was employed by DMC from October 2009 to October 2016. He reported to Mr Kelly. His job title was "sales executive" – his speciality was trading in the printer consumables market (this is what he had done in a number of prior roles). As part of this, Mr Talati managed many of the Distribution business' relationships with key customers and suppliers. During the period relevant to this appeal, he worked from home, when not visiting suppliers and customers, but came to the Croydon office periodically for meetings.

37. Mr Talati had worked for two companies that were competitors of the DMC's Distribution business – East Central Business Machines (from 1996 to 2002) and Beta Distribution plc (from 2002 to 2008). For about a year prior to his joining DMC, he worked for Fender Group Ltd, a venture started by one of his colleagues at Beta Distribution, but left when this went into administration in October 2009. Mr Talati had been a director of Fender Group Ltd and, subsequent to its going into insolvency, Mr Talati was subject to a two-year director's disqualification.

38. At DMC Mr Talati was paid a basic annual salary of £50,000 plus commission calculated as follows at times relevant to this appeal:

(1) 15% of gross profit achieved on his sales

(2) 20% of total gross profit of the business, subject to:

(a) the business achieving £650,000 gross profit;

(b) there being no stock aged over 3 months which DMC had to "lose profit in funding" to sell (if this happened, the funding "used" to sell stock together with the lost profit was deducted from any commission);

(c) there being no returns that DMC was unable to sell (if this happened, the funding "used" to sell the stock, together with the lost profit, was deducted from any commission);

(d) there being no losses due to bad debts not covered by DMC's credit insurer, Euler Hermes. Profit lost by DMC from any bad debts was deducted from any commission.

(3) An additional bonus if DMC were sold: calculated as 10% of the difference between gross profit on his sales and his attributed costs within DMC, per year. If Mr Talati achieved total sales of £1 million for the year to September 2012 then the bonus rate was increased to 20%.

39. Mr Talati's earnings from DMC (before deduction of tax) per tax year were as follows:

(1) 2011-12: £248,112

(2) 2012-13: £131,830

(3) 2013-14: £119,151

(4) 2014-15: £117,009

(5) 2015-16: £157,761

(6) 2016-17 (until his departure in October 2016): £114,757

40. Mr Talati was highly esteemed by DMC for his abilities as a salesman and trader: he was seen as a star performer.

DMC and VAT

41. DMC registered for VAT in 1991 and submitted VAT returns on a quarterly basis.

42. DMC's VAT payment position with HMRC over the 18 quarterly periods from 5/12 to 8/16 (when the Purchases took place) was as follows (VAT credit positions shown in brackets):

Period	VAT payment position with HMRC (£)
5/12	15,651
8/12	57,035
11/12	56,735
2/13	158,037
5/13	16,223
8/13	53,696
11/13	(62,586)
2/14	1,768
5/14	(75,273)
8/14	220,420
11/14	136,882
2/15	8,990
5/15	(164,469)
8/15	136,455

11/15	(5,677)
2/16	(198,673)
5/16	(533,374)
8/16	(429,896)

43. As can be seen from the above, DMC was in a VAT credit position in seven of the 18 quarterly periods between 5/12 and 8/16. Its VAT credit positions in the 5/16 and 8/16 quarters, of £533,374 and £429,896 respectively, were the highest of this period of time.

44. DMC's EU sales per quarter exceeded £3m in the 2/12 VAT period but were then between £1m and £3m up to the 11/15 VAT period. In the 2/16 VAT period, they were nearly £4m; and in the next three quarterly periods they exceeded £5m.

Non-routine contact made by HMRC prior to July 2016

45. On 27 January 2011 HMRC wrote to DMC saying that the VAT number of one of its counterparties, Ebit Distribution Ltd, had been cancelled and that any input tax claimed in relation to transactions with Ebit after the date of deregistration (24 January 2011) may fall to be verified.

46. On 17 October 2012 HMRC officers contacted Mr Hill and spoke to him for about five minutes on the telephone. They asked if DMC had made any transactions with a company called Platinum Components Ltd; Mr Hill responded that DMC had sold it a photocopier for £1,200. Mr Hill gave HMRC his and Mr Cook's direct phone numbers in case of further questions.

47. On 18 December 2012 an HMRC officer contacted Mr Cook and spoke to him for about 10 minutes on the telephone. The officer first asked if DMC had traded with a business called Magnum Logistics – Mr Cook responded that DMC had not. The officer then asked if DMC had purchased ink cartridges from Zvonim D.O.O. ("**Zvonim**"), a Slovenian company; Mr Cook responded that DMC had completed several transactions, the last one being in 2010. Finally, the officer gave Mr Cook dates of purported transactions between Zvonim and DMC; Mr Cook responded that, per DMC's computer records, these transactions had not taken place.

48. In February 2014 an HMRC officer involved in a VAT exchange of information request from the Polish tax authorities about a supply from DMC to a Polish company called Praxis SA, spoke to Mr Cook; Mr Cook confirmed that DMC traded with Praxis SA; after checking invoices, Mr Cook said he agreed that a transaction with Praxis SA had taken place; and that a total sales figure was materially accurate (only out by an immaterial amount). The HMRC officer's internal note of the conversation added that DMC "has not been proven to be involved in MTIC at present and we intend to take no further action".

The Pricemo and Blue Arrow Purchases and on-sales: further details

49. DMC's contact at both Pricemo and Blue Arrow was Hafeez Rehman, who made first contact with DMC, whilst at Pricemo, via a "cold call", offering goods which DMC might want to buy. Mr Rehman dealt both with Mr Talati and with the DMC staff who specialised in buying goods for "stock" and sold to UK customers.

50. DMC made four Purchases of Pricemo Goods in May 2012, the first month in which it bought from Pricemo, totalling just under £450,000. By the end of September 2012, DMC

had purchased over £1.1 million of Pricemo Goods. DMC then did not Purchase from Pricemo again until October 2014.

51. Deliveries of Pricemo and Blue Arrow Goods did not always go smoothly – Hafeez Rehman came in for meetings with Mr Kelly and others in the Distribution business to discuss the problems: deliveries to DMC not arriving on time; sometimes when the deliveries were inspected by DMC some products were found to be damaged or missing. The DMC's witnesses' evidence was that DMC felt that Mr Rehman corrected these problems sufficiently such that DMC continued to buy from Pricemo and Blue Arrow.

52. Pricemo's invoices had the following wording: "Title of Goods remain with Pricemo until full payment is not (sic) received. Terms strictly 30 days in accordance with our terms and conditions on credit accounts".

53. DMC made payment for the Pricemo and Blue Arrow Goods prior to the date shown as "due date" in DMC's purchase ledger transaction report (the amount prior ranged from a few days to about a month). Many payments for Blue Arrow Goods were made prior to the 5 days' credit recorded on the DMC "Approved Supplier" form for Blue Arrow.

54. DMC's last Purchase from Pricemo was in January 2015. Around that time, Hafeez Rehman told Mr Talati that Pricemo's printer consumable business was being transferred to Blue Arrow; he said this was because Pricemo wanted an affiliate in Pakistan using the "Pricemo" name to be a licensee of Walt Disney merchandise (and therefore wanted to the printer consumables business to be under a different name). Mr Rehman sent Mr Talati an email to this effect on 14 January 2015 (which Mr Talati in turn forwarded to Mr Cook). Mr Rehman referred Mr Talati to a website, which Mr Talati accessed, of a company in Pakistan with the name "Pricemo", which was a Walt Disney licensee.

Pricemo: corporate details and VAT

55. Pricemo was incorporated in 2008; Hafeez Rehman was a director from 2010. Pricemo applied to be registered for VAT in 2009 showing a business activity of "IT consulting services / Other professional, scientific and technical activities". In February 2012 HMRC received notification of a transfer of a business as a going concern, and request for transfer of a VAT registration number, to Pricemo; this showed a business address in Empire Way, Wembley and business activities of "retail of stationery and other office supplies".

56. Pricemo did not submit VAT returns for VAT periods 08/12 and 11/12 and submitted nil VAT returns for periods 02/13 – 08/14 and final. On 22 October 2014 HMRC wrote to Pricemo stating that it would be deregistered for VAT with effect from 3 October 2014.

57. A simple online credit check ("Optima") for Pricemo based on its 30 April 2013 accounts commented that

(1) the company made a post tax, post appropriation profit of £12,164;

(2) liquidity had improved over the past year from net current assets of £10,872 to net current assets of £32,810;

(3) bank and cash figures totalled £13,537;

(4) reserves stood at £35,255;

(5) for credit insurance purposes the credit limit was nil.

Blue Arrow: corporate details and VAT

58. Blue Arrow was incorporated in 2011. On 8 January 2014 Blue Arrow changed its registered address to Empire Way, Wembley. Mr Rehman was a director from 15 October 2014 to 1 June 2015 and again from 25 November 2016 (and so was not a director during the time when most of the Blue Arrow Purchases took place). Rashid Khalid was appointed a director on 1 February 2015. According to tax records held by HMRC, Mr Khalid was employed by a money exchange business in the 2013-14 tax year.

59. Blue Arrow applied to be registered for VAT with effect from 11 July 2011, indicating a business activity of motor trading. On 28 July 2014 Blue Arrow notified HMRC of a change of trade classification to "IT consultancy and supply". On 24 November 2014 Blue Arrow notified HMRC of a change of principal place of business to Montrose Avenue, Slough. On 7 August 2015 Blue Arrow notified HMRC of a further change of principal place of business to Empire Way, Wembley.

60. Blue Arrow filed nil VAT returns from 11/13 – 02/16 and then filed no VAT returns from the 05/16 quarter onwards. Blue Arrow was deregistered for VAT with effect from 18 August 2016.

61. A simple online credit check for Blue Arrow ("Fame") dated 24 October 2016 showed (inter alia) net assets of £817, 2.3% likelihood of failure and a £8,244 credit limit.

62. When Blue Arrow entered insolvency its unsecured creditors included a number of non-UK EU companies. This indicates that Blue Arrow had been purchasing from these EU companies. Some of those companies were also DMC customers, managed by Mr Talati.

Document checks on Blue Arrow

63. DMC collected the following documents regarding Blue Arrow:

(1) a DMC "Approved Supplier" form signed by Hafeez Rehman as a director of Blue Arrow after the statement "I confirm that I am authorised to sign this application and have read, understood and retained a copy of your terms and conditions and agree to trade in accordance with these for any goods supplied", dated 22 January 2015 and countersigned ("for DMC internal use only") on the same day; it recorded 5 days' credit and no agreed credit limit;

(2) a VAT certificate issued on 4 December 2014; it recorded a trade classification of "Management Consultancy (Not Financial)"; the bank account details shown were different from those on Blue Arrow's invoices;

(3) a BT bill addressed to Blue Arrow dated 21 December 2014;

(4) a certificate of incorporation dated 11 July 2011; and

(5) blank Blue Arrow letterheads.

The Vision Purchases and on-sales: further details

64. DMC's relationship with Vision came through Zulfi Khan, who worked for Lampton Solutions Ltd ("**Lampton**"), a supplier to DMC, and then moved to Vision. Zulfi Khan first approached Mr Talati about the possibility of DMC buying Vision Goods.

65. The prices of the Vision Purchases and on-sales to Item were agreed in Euros: Item preferred to pay DMC in Euros (as this was Item's functional currency) and DMC agreed with Vision that it would pay in Euros (so reducing currency risk for DMC).

66. DMC's first Purchase from Vision, on 30 April 2015, was of Goods costing €258,206 (net of VAT). On 21 May 2015 DMC purchased further Vision Goods costing €257,128 (net of VAT).

67. From DMC's perspective, Vision's deliveries of the Vision Goods to DMC went smoothly.

68. DMC made payment for the Vision Goods prior to the date shown as "due date" in DMC's purchase ledger transaction report (the amount prior ranged from a few days to about a month). The due date in the purchase ledger did not, however, in general reflect the (much shorter) 5-day credit shown on the "Approved Supplier" form for Vision.

69. In the 03/16 VAT quarter, Vision's profit on purchases of just over £1.6 million was about £14,000 – or just under 1%. When Mr Cook was given this information in August 2016, he commented that Vision's profit margin was "exceptionally low".

70. Vision's invoices had the following wording: "Please note all goods remain the property of [Vision] until paid for in full".

Vision: corporate details and VAT

71. Vision was incorporated in July 2014. Its principal place of business was at Wenlock Rd, London from August 2015. Its warehouse was a unit in a "Safe Store" premises.

72. Joey Mason became a Vision director on 8 April 2015. Tax records held by HMRC indicated that Mr Mason had worked for Kwik Fit (GB) Ltd until April 2012, and thereafter for Car Parks Ltd; from May 2016 he was a director of Total Mobiles Tyres Ltd; he was also recorded as working as a self-employed builder.

73. Vision was registered for VAT with effect from 9 July 2014 showing a main business activity of "reseller of electronic office supplies". Vision submitted nil returns from 09/14 until 03/15.

74. A simple online credit check ("Optima") for Vision based on its 31 July 2015 accounts commented that

(1) it made a post-tax, post-appropriation profit of £2,099 during the first trading period;

(2) its net current assets were £2,100;

(3) its bank and cash figures total was £8,557;

(4) its reserves stood at £2,099;

(5) they were unable to suggest a credit figure and recommended the provision of suitable assurances. For credit insurance purposes the credit limit was nil.

Vision's supplier: Bryanswood

75. Vision paid Bryanswood for the Vision Goods by transferring funds to the account of IPVDX (Escrow) Ltd at Societe Generale Bank in Cyprus.

76. Bryanswood was incorporated in December 2013. On 5 December 2014 HMRC received an application for VAT registration from Bryanswood which stated its main business activity as "marketing services" and principal place of business as at Royston Mains St., Edinburgh. On 21 April 2015 Bryanswood informed HMRC that it had changed its trading activity to "wholesale of office equipment and other office machinery".

77. Bryanswood submitted nil VAT returns from its registration.

Document checks on Vision

78. DMC collected the following documents and/or took the following steps as regards Vision:

(1) a DMC "Approved Supplier" form signed by Mr Mason as the director of Vision, after the statement "I confirm that I am authorised to sign this application and have read, understood and retained a copy of your terms and conditions and agree to trade in accordance with these for any goods supplied" and dated 16 April 2015; it provided Zulfi Khan's contact details; it was countersigned ("for DMC internal use only") by Mr Cook on 25 May 2015; it recorded 5 days' credit and an agreed credit limit of 300,000;

(2) Mr Cook sent emails on 21 May 2015:

(a) to Mr Bruce, saying: "Another delivery from Vision. Can you carry out various check [sic] including five samples that we both can evaluate. I will be contacting Vision today to gain confidence from the owners to support this current arrangement";

(b) to a member of Mr Cook's staff, saying: "Can you investigate Vision even though we have done this before, check out the directors and any associated companies. Look for websites so we have a comprehensive assessment";

(c) to Mr Talati, saying:

> "As discussed, as part of our internal supply chain risk assessment we need to ensure we have robust procedures in place for assessing the suitability of new suppliers and that these procedures are adhered to when sourcing products from new suppliers.
>
> Central to this is the need to verify the identity of both the company and appointed directors.
>
> Can you therefore provide me with the following:
>
> Company bank account statement;
>
> VAT registration certificate;
>
> Director residential address;
>
> Main company telephone number;
>
> Director email address and telephone number;
>
> Accountant contact details
>
> I may have further requests but for now the above will suffice";

(3) a VAT certificate for Vision issued on 10 April 2015 with a business activity description of "wholesale of computers, computer peripheral equipment and software";

(4) an email from Zulfi Khan to Mr Talati dated 21 May 2015 giving Mr Mason's residential address, email and telephone number; Vision's phone number; and the details of Vision's accountants;

(5) internal DMC emails confirming that Vision's accountant had been identified;

(6) a bank statement for Vision for a Euro currency account, addressed to Mr Mason's personal address, dated 30 April 2015; and

(7) an invoice dated 20 July 2016 from Safestore to Mr Mason for the hire by month of a storage unit.

79. DMC's purchase ledger transaction record indicates that some payments of over £300,000 (net of VAT) were made.

Document checks on DMC's customers for the Vision Goods

80. The documents collected by DMC on Item were as follows

(1) a DMC "Credit Account Application Form" signed on 26 April 2016 (Item did not provide trade references on the form);

(2) some Item letterheads;

(3) a Euler Hermes approved limit request reply dated 10 March 2016 raising the limit from £750,000 to £1.1 million;

(4) a Euler Hermes approved limit request reply dated 2 August 2016 raising the limit from £750,000 to £1.1 million; and

(5) a Creditsafe report dated 17 May 2017 (showing the credit score as very low risk).

81. The documents collected by DMC on Printberry were as follows:

(a) a DMC "Credit Account Application Form" signed on 25 February 2016 (Printberry did not provide trade references on the form);

(b) a Creditsafe report dated 26 February 2016 (which said both that the credit score was "low risk" and that "company's solvency is weak and is entirely dependent on external capital"); and

(c) a Euler Hermes approved limit request reply dated 9 February 2017 approving a £50,000 limit (with reminder that the approved limit prior to the decision was £0).

82. The documents collected by DMC on Al Noori were as follows:

(a) a DMC "Credit Account Application Form" signed on 10 February 2016 (Al Noori did not provide trade references on the form);

(b) A Euler Hermes reduction of approved limit document dated 24 November 2016 reducing limit from £500,000 to £250,000.

Item and DMC's relationship with it

83. Item was an Austrian company whose activities included wholesaling of office supplies; it had been operating since 1979; its turnover in the years in question was around €100 million; its net assets around €11 million; it had 50 employees in 2019.

84. DMC first supplied products to Item in February 2010. In the five years to 31 March 2014, DMC's sales to Item were between half a million and one million pounds per year. Sales increased to £1.6 million in the year ended 31 March 2015, and then were £4.3 million and £4.6 million in the years ended 31 March 2016 and 2017 respectively. In total Item purchased products costing £13.4 million from DMC between 2010 and 2016. The average

gross profit margin that DMC made on sales to Item in the four years ended 31 March 2014-2017 was just over 5%.

85. Item had six main suppliers for Canon inks, including DMC. Two of these gave Item a 8-9.5% discount from the official distributor price; DMC gave a 6.5% discount. In Item's view, DMC's advantage over the cheaper suppliers was that it could supply 100% of the ink that Item needed (as opposed to the cheaper suppliers, who could only supply 75%).

86. Mr Talati had secured Item as a customer of DMC and managed DMC's relationship with Item at the relevant times.

Lampton – a supplier to DMC; and where Zulfi Khan worked before Vision

87. Between November 2014 and March 2015 DMC made eight purchases from Lampton costing €1.4 million (net of VAT) in total. DMC's relationship with Lampton was managed by Mr Talati.

88. Lampton was incorporated in 2013. Lampton applied to be registered for VAT in February 2013, showing an address in St John Street, London and its business activity as "accountancy".

89. Aiden Patsalides became a director of Lampton in February 2014. Mr Patsalides signed DMC's "Approved Supplier" form in respect of Lampton in March 2014.

90. Lampton rendered nil VAT returns for periods 04/13 – 04/14 inclusive. In March 2014 Mr. Patsalides notified HMRC that Lampton's principal place of business address had changed to Sandy Lane Business Park, Beds. Lampton did not notify HMRC of a change of business activity.

91. On 9 April 2015 HMRC officers met with Mr Patsalides and Zubair Talati (Mr Aziz Talati's brother) at Lampton's office. Zubair Talati was described in HMRC's notes of the meeting as the business manager; Zulfi Khan was not mentioned. Zubair Talati was noted as having business expertise, having been previously employed by ACI Adam, in contrast to Mr Patsalides, whose background was noted as being in construction (HMRC's notes said Mr Patsalides was a carpenter and was site based in his other construction work). Lampton's suppliers were recorded in HMRC's notes as Zenica Enterprises Ltd ("**Zenica**") and 3D Media Ltd ("**3D**"); its customers were DMC and one other company. HMRC's notes said that 3D had been deregistered since 4 November 2014 and that Zenica was a "missing trader".

92. On 13 April 2015 HMRC sent Lampton a letter containing advice on risks associated with MTIC and procedures for validating VAT registration details of trading partners with HMRC.

93. HMRC notified Lampton by letter of 5 June 2015 that it had been deregistered for VAT with effect from 1 June 2015 by reason of ceasing to make taxable supplies.

94. Lampton was dissolved on 19 January 2016.

Lampton: connections with bogus companies ordered into liquidation in 2016

95. A press release from the Insolvency Service dated 4 March 2016 regarding six bogus companies (of which 3D was one, as well as Unique Wholesale Ltd, Zen IT Ltd and Hydro Serv Ltd) ordered into liquidation by the High Court said that all but one had been incorporated by ABN Company Formations Ltd ("**ABN**"), a company run by Jade Evans; it said that that the court had heard that 50 other companies had been formed by Ms Evans and utilised as part of an extensive network of companies engaged in systematic fraud.

96. Lampton was formed by ABN; Jade Evans was a first director. Lampton's St John Street, London address was also the address of 3D, Zenica and Unique Wholesale Ltd at various times.

97. 3D and Hydro Serv Ltd had a registered office address at Wenlock Rd, London until 9 December 2014. This was also the address that Vision notified as its new address on 25 August 2015.

98. Zenica was formed by ABN and initially registered at the St John Street, London address. Lucy Masters was a director of both Zenica and Hydro Serv Ltd. Zenica was registered for VAT from 1 January 2015 but deregistered with effect from 12 May 2015.

Various linkages

Link between Pricemo/Blue Arrow and Vision, via Mr Mayet

99. Vision made three payments to a Mr Mayet between August 2015 and March 2016, totalling about £16,000. Mr Mayet was

(1) a director of company registered at the same Empire Way, Wembley address that was used by Pricemo and Blue Arrow at certain points in time; and his co-director at that company (Mr Wadood) was also a director of Pricemo; and

(2) a director of another company which was registered at the same Wenlock Road address that was used by Vision and Lampton at certain points in time.

Links with Zubair Talati

100. Mr Talati's brother, Zubair Talati

(1) received nine payments totalling £7,500 in October-December 2010 from Ebit Distribution Ltd, the company that HMRC wrote to DMC about in January 2011 saying that it had been deregistered for VAT;

(2) had, sometime before a report from the Slovenian tax authorities in February 2013, proposed sales by Zvonim and another Slovenian company, Iteks D.O.O. ("**Iteks**"), to two UK companies that went "missing" i.e. defaulted on their VAT obligations – Asia Pacific Sourcing (UK) Ltd and Orclo Ltd.

101. DMC purchased several hundred thousand pounds worth of printer consumables from Zvonim between November 2009 and April 2010, and from Iteks in September 2011. DMC's systems showed Mr Talati's initials in the "supplier reference number" box for Iteks.

102. Ebit Distribution Ltd traded with Asia Pacific Sourcing (UK) Ltd

103. Iteks supplied goods to companies including Item and ACI Adam B.V.

104. A director of Orclo Ltd was also a director of another company whose registered office was at the Empire Way, Wembley address used at some points in time by Pricemo and Blue Arrow.

CE Logistics Ltd

105. CE Logistics Ltd first approached DMC with a view to selling HP toner by means of a "cold call" in 2014 from the director, Alexander MacGregor, who was an acquaintance of one of the directors of DMC. Over the next five years, CE Logistics Ltd sold some £36 million of printer consumables to DMC (and, as noted above, was the Distribution business' largest supplier).

106. Mr MacGregor was convicted in November 2019 of conspiracy to produce Class C controlled drugs (illegal steroids) during the period 2009-2015.

RELEVANT LAW

EU VAT directive

107. Council Directive 2006/112/EC of 28th November 2006 on the common system of VAT provides as follows:

> **Article 167**
>
> A right of deduction shall arise at the time the deductible tax becomes chargeable.

Article 168

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

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

…

Value Added Tax Act 1994

108. Section 24 (Input tax and output tax) provides:

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

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

being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

(2) Subject to the following provisions of this section, "output tax", in relation to a taxable person, means VAT on supplies which he makes…

109. Section 25 (Payment by reference to accounting periods and credit for input tax against output tax) provides:

(1) A taxable person shall-

(a) in respect of supplies made by him…

account for and pay VAT by reference to such periods (in this Act referred to as "prescribed accounting periods") at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.
(3) if either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then, subject to [subsections not relevant here], the amount of the credit, or as the case may be, the amount of the excess shall be paid to the taxable person by the Commissioners; and an amount which is due under this subsection is referred to in this Act as a "VAT credit".

110. Section 26 (Input tax allowable under section 25) provides:

(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies…) as is

allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business – …

(a) taxable supplies;

(b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;…"

Case law

Kittel

111. The European Court of Justice (the "CJEU"), in its judgment dated 6 July 2006 in *Axel Kittel v Belgium State, Belgium State v Recolta Recycling SPRL* C- 439/04 & C-440/04, held that taxable persons who "knew or should have known" that the supplies in which input tax was incurred were connected with the fraudulent evasion of VAT would not be entitled to claim a credit in respect of that input tax. In particular, at [51] and [56], the CJEU, whilst reiterating that "traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it fraudulent evasion of VAT or other fraud" should not lose their right to a credit for the input tax in relation to supplies associated with fraud, stated that "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 [directive which has now been replaced by the 2006 Directive], be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods."

112. The rationale for the above approach was set out at [57] and [58], where the CJEU noted the following:

[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."

113. At [59] the CJEU concluded that "it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'."

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

Mobilx

115. The issues to which *Kittel* gave rise were addressed in the UK context by the Court of Appeal in *Mobilx Limited (in Liquidation) v HMRC* [2010] EWCA Civ 517. At [52], Moses LJ said as follows in relation to the "should have known" part of the *Kittel* test:

"If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a

penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in *Kittel*. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

116. At [53] to [60] Moses LJ addressed the extent of knowledge required. He observed that it would offend the principle of legal certainty to deny input tax credit on the grounds that the relevant taxpayer knew or should have known that it was *more likely than not* that the supplies in question were connected with fraud. Instead, such denial could be made only if the relevant taxpayer knew or should have known that the supplies in question *were* connected with fraud. At [59-60] Moses LJ observed that:

> "[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."

117. At [61] Moses LJ said the following about legal certainty:

> "A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."

118. At [64] Moses LJ reiterated that, "[if] it is established that a trader should have known that by his purchase there was no reasonable explanation for the circumstances in which the transaction was undertaken other than that it was connected with fraud then such a trader was directly and knowingly involved in fraudulent evasion of VAT*"*

119. At [74-75] Moses LJ referred to a tribunal's "undue focus" on whether a company director had "exercised due diligence or done 'enough to protect himself'". Moses LJ then stated: "That is not the only question. The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT."

120. At [81] and [82] Moses LJ noted that the burden of proof in such cases is on HMRC but made it clear that that "is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant …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.*"*

121. At [72] Moses LJ cited "important" questions posed by the First-tier Tribunal in *Mobilx*:

> "(1) Why was [the taxpayer], a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?
>
> (2) How likely in ordinary commercial circumstances would it be for a company in [the taxpayer's] position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone.
>
> (3) Was [the taxpayer's supplier] already making supplies direct to other EC countries? If so, he could have asked why [the taxpayer's supplier] was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.
>
> (4) Why are various people encouraging [the taxpayer] to become involved in these transactions? What benefit might they be deriving by persuading [the taxpayer] to do so? Why should they be inviting [the taxpayer] to join in when they could do so instead and take the profit for themselves?"

122. At [83] Moses LJ said that the above "were important questions which may often need to be asked in relation to the issue of the trader's state of knowledge" and added that he could "do no better" than repeat the words of Christopher Clarke J in *Red 12 Trading Limited v HMRC* [2010] STC 589:

> "[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."

123. At [84], Moses LJ observed that circumstantial evidence of the sort described by Christopher Clarke J in *Red 12* will often indicate that "a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable reward over a short space of time."

Davis & Dann

124. In considering the "should have known" test, the Court of Appeal (Arden LJ) in *Davis & Dann Ltd & Anor v HMRC* [2016] EWCA Civ 142 said that the tribunal must guard against over compartmentalisation of the factors, rather than the consideration of the totality of the evidence. The court said the Tribunal is not restricted from relying on any circumstance which is capable of being probative of knowledge to the no other reasonable explanation standard. It was not correct to argue that, simply because there was no allegation that X was a party to a scheme to defraud, no circumstance surrounding X could be a circumstance, which, when added together with other circumstances, should have led HMRC to conclude there was a connection with fraud. Arden J then cited the last sentence of [52] of *Mobilx* (concerning a trader who fails to deploy means of knowledge available to him) and observed that a taxpayer may have knowledge to the "only reasonable explanation" standard if he fails to make inquiries.

125. The judgement in *Davis & Dann* explored the interaction between "no reasonable explanation" test and factual findings as "normal course of business" in a "grey market". The Court of Appeal said that the function of a finding as to "normal course of business" was to rebut knowledge on the part of the taxpayer to the "no other reasonable explanation" standard. To serve that purpose, it had not only to be a finding as to what was in the normal course of business among grey market traders but also, in general, a finding as to what was in the normal course of the taxpayer's business. The two were not necessarily the same thing. The ordinary course of a business of a trader in the grey market might, for instance, be with particular kinds of dealer only or in particular kinds of goods only. HMRC had discharged the burden of proof that the transactions had not been in the ordinary course of the taxpayer's business by the evidence as to the terms of credit given by the supplier (it agreed to be paid only when the taxpayer was paid by its customer). The Court of Appeal found that, as a matter of commercial common sense, it was inherently improbable that the supplier's extended credit terms given to the taxpayers had been in the ordinary course of business. In those circumstances, the burden of adducing evidence had moved to the taxpayer to show that the transactions had been normal market transactions. The First-tier Tribunal had been entitled to draw adverse inferences from the size of the transactions as a circumstance relevant to the question whether the taxpayers had had knowledge to the requisite standard of a connection with fraud and the extended credit was further a factor which the tribunal had been entitled to find had been unusual and which contributed to the finding of the requisite standard of knowledge. Accordingly, the Upper Tribunal had erred in setting aside the tribunal's evaluation.

Other authorities

Nature of circumstantial evidence

126. Pollock CB in *R v Exall* (1866) 4 F & F 922 made the comparison between circumstantial evidence and a rope comprised of several cords:

> "One strand of the cord might be insufficient to sustain the weight, but three stranded together may be quite of sufficient strength. Thus it may be in circumstantial evidence - there may be a combination of circumstances, no one of which would raise a reasonable conviction, or more than a mere suspicion: but the whole taken together, may create a strong conclusion of guilt, that is, with as much certainty as human affairs can require or admit of."

Proving "only reasonable explanation"

127. In *AC (Wholesale) Ltd v HMRC* [2017] UKUT 191 (TCC) the Upper Tribunal decided that the 'should have known' test did not require HMRC to eliminate all other possible reasonable explanations in order to establish, as required by *Mobilx*, that the only reasonable explanation for the transactions was that they were connected to fraud. It added (at [30]:

> "Of course, we accept (as, we understand, does HMRC) that where the appellant asserts that there is an explanation (or several explanations) for the circumstances of a transaction other than a connection with fraud then it may be necessary for HMRC to show that the only reasonable explanation was fraud. As is clear from *Davis & Dann*, the FTT's task in such a case is to have regard to all the circumstances, both individually and cumulatively, and then decide whether HMRC have proved that the appellant should have known of the connection with fraud. In assessing the overall picture, the FTT may consider whether the only reasonable conclusion was that the purchases were connected with fraud. Whether the circumstances of the transactions can reasonably be regarded as having an explanation other than a connection with fraud or the existence of such a connection is the only reasonable explanation is a question of fact and evaluation that must be decided on the evidence in the particular case. It does not make the elimination of all possible explanations the test which remains, simply, did the person claiming the right to deduct input tax know that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT or should he have known of such a connection."

Not necessary to prove which aspects of multi-faceted fraud taxpayer knew (or should have known) of

128. In *Megtian Ltd (In Administration) v HMRC* [2010] EWHC 18 (Ch) Briggs J observed that, in cases about a taxpayer's transaction's connection to sophisticated fraud, HMRC do not have to prove exactly which aspects of the multi-faceted fraud the taxpayer knew or should have known of:

> "[37] In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.
>
> [38] Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including *Livewire*, that may be an appropriate basis for analysis."

129. In a case where there was evidence of an "overall contra-trading scheme" and circularity, the High Court held that the Tribunal was justified in considering that such

evidence indicated that the taxpayer knew to whom it was supposed to sell: see *Regent Commodities Limited v HMRC* [2011] UKUT 259 (TCC) (Newey J) at [46].

Taxpayer does not need to know specific details of the fraud

130. In *Fonecomp Ltd v HMRC* [2015] STC 2254 at [51] the Court of Appeal (Arden LJ) said this:

> "… the holding of Moses LJ does not mean that the trader has to have the means of knowing how the fraud that actually took place occurred. 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 transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge. This is apparent from paras 56 and 61 of *Kittel* cited above. Paragraph 61of *Kittel* formulates the requirement of knowledge as knowledge on the part of the trader that 'by his purchase he was participating in a transaction connected with fraudulent evasion of VAT'. It follows that the trader does not need to know the specific details of the fraud."

Need to consider whether appellant participated in an "overall scheme to defraud"

131. As was noted by Hildyard J in *Edgeskill Ltd v HMRC* [2014] STC 1174, the question whether the appellant participated in an "overall scheme to defraud" informs, but does not answer, the question whether the appellant knew or should have known that it was participating in such a scheme.

Need to consider making inferences from evidence of highly orchestrated scheme

132. In *HMRC v Pacific Computers Limited* [2016] UKUT 350 (TCC), the Upper Tribunal held the FTT had erred in law by not properly considering the inferences it was invited (by HMRC) to make from unchallenged evidence that (i) there was a high level of orchestration in the fraudulent scheme, including carouselling of goods, circularity of deal chains, and speed (ii) three of the companies in the deal chain had previously taken part in MTIC fraud. On the basis of this evidence, HMRC invited the tribunal to infer that the taxpayer was instructed by the organisers of the fraud as to what to do in order to facilitate the fraud; and so the taxpayer knew of the fraud. The Upper Tribunal said at [81-82]:

> "[81] It is regrettable that the FTT failed to appreciate the inferences which HMRC was inviting the FTT to make from the orchestrated and contrived nature of the fraud and the presence of fraudulent companies within the deal chains at issue in the appeal ….
>
> [82] Although, as for example at [140], when describing its conclusion that [the taxpayer] had no actual knowledge of fraud in the chains, the FTT stated that it had carefully considered all the evidence before it in reaching that conclusion, and that it had done so "because there was no evidence before us to show otherwise and no evidence laying a foundation from which such an inference could be drawn", it is evident from how the FTT later addressed the question of orchestration and contrivance that it did not consider, or did not properly address, the evidence before it. Where there is evidence, and it is evidence from which the tribunal is invited to make an inference, the tribunal must address that question and explain its reasons either for drawing an inference or refusing to do so. It is not sufficient simply to say that there was no evidence. The failure by the FTT properly to address the submissions of HMRC by reference to the available evidence was an error of law."

No need to determine whether the conduct alleged by HMRC amounts to dishonesty or fraud by the taxpayer, unless HMRC expressly allege this

133. In *E Buyer UK Ltd v HMRC and HMRC v Citibank NA* [2017] EWCA Civ 1416 (Court of Appeal), Sir Geoffrey Vos C summarised the applicable law as follows:

"(i) The test promulgated by the CJEU in *Kittel* was whether the taxpayer knew or should have known that he was taking part in a transaction connected with fraudulent evasion of VAT.

(ii) Ultimately the question in every *Kittel* case is whether HMRC has established that the test has been met. The test is to be applied in accordance with the guidance given by the Court of Appeal in *Mobilx* and *Fonecomp*.

(iii) It is not relevant for the FTT to determine whether the conduct alleged by HMRC might amount to dishonesty or fraud by the taxpayer, unless dishonesty or fraud is expressly alleged by HMRC against the taxpayer. If it is, then that dishonesty or fraud must be pleaded, particularised and proved in the same way as it would have to be in civil proceedings in the High Court.

(iv) In all *Kittel* cases, HMRC must give properly informative particulars of the allegations of both actual and constructive knowledge by the taxpayer…"

The tribunal's task in the "should have known" limb of Kittel

134. The Upper Tribunal said this in *S&I Electronics plc v HMRC* [2015] STC 2076 (at [64]) of the tribunal's task in approaching the "should have known" limb of Kittel:

"… the FTT's task was to apply the impersonal standard of the reasonable businessman to the facts which it found, on the basis of the evidence which it heard, as to the circumstances in which S&I carried out the transactions in issue. Would the reasonable businessman have concluded that S&I ought to have known that the only reasonable explanation for the transactions was that they were connected with fraud?"

135. The First-tier Tribunal (Judge Falk, Mr Robinson) in *Synectiv Ltd v HMRC* [2018] UKFTT 0092 (TC) (at [117]) referred to this guidance from *S&I Electronics* when considering the operation of a "grey market", as follows:

"It is clear from the guidance in S&I Electrical that we should seek to apply the standard of a reasonable businessman. However, our approach must also be informed by the evidence available about what the typical features of grey market trading were at the time. If the disputed transactions did not stand out against that backdrop then that is clearly relevant in determining whether Synectiv should have known that they were connected with fraud."

136. In *HMRC v Beigebell Ltd* [2020] UKUT 176 (TCC) it was common ground that the question of 'means of knowledge' involved the application of an objective test namely whether, even if the taxpayer did not actually know that its transactions were connected with fraud, a reasonable businessperson with ordinary competence in its position would have known.

Relevance of due diligence

137. The Upper Tribunal said this of the relevance of due diligence in *CCA Distribution Ltd (in administration) v HMRC* [2015] UKUT 513 (TCC) at [52], immediately after citing *Mobilx* at [75]:

"Nonetheless, the exercise of due diligence or the lack of due diligence can potentially be relevant. If the trader has not carried out due diligence in relation to a transaction, that might assist HMRC in showing that the trader knew or should have known that the transaction was connected with fraud. Conversely, if due diligence has been exercised by the trader, that fact might not be conclusive as to whether the trader did not know or should not have known that a transaction was connected with fraud; the due diligence might have been done as window dressing and there might be other evidence which established that the trader knew or should have known that the transaction was connected with fraud."

Authorities on credibility of evidence

138. In *Wetton v Ahmed* [2011] EWCA Civ 610 Arden LJ said at [14]:

> ''In my judgment, contemporaneous written documentation is of the very greatest importance when assessing credibility. Moreover, it can be significant not only where it is present and the oral evidence can be checked against it. It can also be significant if the written documentation is absent. For instance, if the judge is satisfied that certain contemporaneous documentation is likely to have existed were the oral evidence correct, and the party adducing oral evidence is responsible for its non-production, then the documentation may be conspicuous by its absence and the judge may be able to draw inferences by its absence''.

139. Leggatt J observed as follows in *Gestmin SGPS SA v Credit Suisse (UK) Ltd* [2013] EWHC 3560 (Comm) at [22]:

> "In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

140. The Court of Appeal in *Kogan v Martin* [2019] EWCA Civ 1645 made the following observations on Leggat J's statements in *Gestmin* (at [88]):

> "We start by recalling that the judge read Leggatt J's statements in *Gestmin v Credit Suisse* and *Blue v Ashley* as an "admonition" against placing any reliance at all on the recollections of witnesses. We consider that to have been a serious error in the present case for a number of reasons. First, as has very recently been noted by HHJ Gore QC in *CBX v North West Anglia NHS Trust* [2019] 7 WLUK 57, *Gestmin* is not to be taken as laying down any general principle for the assessment of evidence. It is one of a line of distinguished judicial observations that emphasise the fallibility of human memory and the need to assess witness evidence in its proper place alongside contemporaneous documentary evidence and evidence upon which undoubted or probable reliance can be placed. Earlier statements of this kind are discussed by Lord Bingham in his well-known essay *The Judge as Juror: The Judicial Determination of Factual Issues* (from The Business of Judging, Oxford 2000). But a proper awareness of the fallibility of memory does not relieve judges of the task of making findings of fact based upon all of the evidence. Heuristics or mental short cuts are no substitute for this essential judicial function. In particular, where a party's sworn evidence is disbelieved, the court must say why that is; it cannot simply ignore the evidence."

141. Lewison J assessed the credibility of the two main witnesses in *Painter v Hutchison & Anor* [2007] EWHC 758 (Ch) as follows:

> "**[3]** Because the documents are so sparse, much turns on the credibility of witnesses; and of the two principal witnesses, Mr Painter and Mr Hutchison, in particular. Mr Painter gave his evidence firmly and clearly. He has been guilty of duplicitous conduct in the past, notably in his dealings with the Inland Revenue. He was prepared to concede this immediately; and indeed said so in his witness statement. But the fact that he has been guilty of duplicity in the past does not necessarily lead to the conclusion that he gave dishonest or unreliable evidence under oath. His account of events has been consistent throughout the progress of this litigation. Mr Hutchison has also been guilty of dishonesty in the past. During the course of the events with which I am

concerned he was convicted in the USA of mortgage fraud. This resulted in (amongst other things) the impounding of his passport. It was released to him from time to time by permission of the US judge, and enables dates of Mr Hutchison's visits to the UK to be established with some accuracy. However, in addition to having been convicted of dishonesty in the past, Mr Hutchison was also a very unsatisfactory witness. Even [his counsel] did not suggest that his evidence was reliable. I will give detailed examples later, but for now I summarise my general impression. He was evasive and argumentative. He would launch into tangential speeches when confronted by questions that he could not answer consistently with his case. He attempted to place the most strained readings on the plain words of his pleaded case and his principal witness statement. He was free with allegations that his previous solicitors and counsel had made mistakes in accurately recording his instructions. At times he gave self-contradictory answers within the space of a few minutes of his evidence. New allegations emerged in the course of his cross-examination which had not previously formed part of his pleaded case or his written evidence. It was impossible not to conclude that they had been made up on the spot. In the course of his cross-examination of Mr Hutchison Mr Cowen convincingly demonstrated to my mind that Mr Hutchison's case had shifted in important respects either in response to evidence given by Mr Painter or in response to documents that had emerged on disclosure. It changed again and again in the witness box itself. His disclosure of documents has been lamentable and highly selective. In my judgment he has deliberately and dishonestly fabricated evidence in order to try to accommodate what was indisputable within the overall framework of his story.

[4] In my judgment Mr Hutchison has also tampered with highly important documents …

[6] In short, Mr Hutchison's evidence cannot be relied on unless it is corroborated by indisputable and contemporaneous documents. Where it conflicts with the evidence of Mr Painter, I have no hesitation in preferring Mr Painter's evidence.

142. In *Bailey v Graham* [2012] EWCA Civ 1469 at [47], the Court of Appeal set out certain well known principles, in chronological order, for a judge to follow or observe in weighing up evidence:

(1) The Judge as Juror (1985) by Lord Bingham of Cornhill pp 6-9 in which he sets out the five main tests for determining whether a witness is lying, namely, consistency with what is agreed or clearly established by other evidence, internal consistency, consistency with previous statements of the witness, the general credit of the witness and his demeanour.

(2) *Eckersley v Binnie* (1988) 18 ConLR 1, 77 which emphasises that if all the evidence points one way good reason needs to be shown for rejecting it.

(3) *Re H* [1996] AC 563, 586 where Lord Nicholls of Birkenhead pointed out that the more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its occurrence will be established.

(4) *Mibanga v Secretary of State of the Home Department* [2005] EWCA Civ 367, 24 which points out that a fact-finder must survey all the relevant evidence before reaching his conclusion.

Authorities on adverse inferences

143. Morgan J summarised the principles of "adverse inferences" in *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2017] EWHC 1191 (Ch) at [141-143]:

"141. The consideration which a court should give to the fact that a potentially relevant witness has not been called is well established. I can take the principles from the judgment of Brooke LJ in *Wisniewski v Central Manchester Health Authority* [1998] PIQR P324 at P340 where, having reviewed the authorities, he said:

"From this line of authority I derive the following principles in the context of the present case:

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

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

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

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

142. This statement of principle is in accordance with the earlier decisions of the House of Lords in *R v IRC ex p. T C Coombs & Co* [1991] 2 AC 283 and *Murray v DPP* [1994] 1 WLR 1 and the comments of Lord Sumption in the Supreme Court in *Prest v Prest* [2013] 2 AC 415 at [44].

143. These principles mean that before I draw an inference and made a finding of fact adverse to a witness who was not called, I need to ask myself:

- is there some evidence, however weak, to support the suggested inference or finding on the matter in issue?

- has the Defendant given a reason for the witness's absence from the hearing?

- if a reason for the absence is given but it is not wholly satisfactory, is that reason "some credible explanation" so that the potentially detrimental effect of the absence of the witness is reduced or nullified?

- am I willing to draw an adverse inference in relation to the absent witness?

- what inference should I draw?"

…

146. … even if I eventually conclude that I have not been given a good reason or a credible explanation for the [party] not calling these three witnesses, it does not follow that I will automatically draw [an adverse] inference In deciding what inferences to draw, I need to take into account not only the fact that [the individuals] were not called, when they could have been, but also other matters such as what I consider to be the most probable finding to make on the basis of all the evidence which I have received.

144. Brooke LJ in *Wisniewski* cited *McQueen v Great Western Railway Company* (1875) LR 10 Q.B. 569, where Cockburn CJ had said:

"If a prima facie case is made out, capable of being displaced, and if the party against whom it is established might by calling particular witnesses and producing particular evidence displace that prima facie case, and he omits to adduce that evidence, then the inference fairly arises, as a matter of inference for the jury and not a matter of legal presumption, that the absence of that evidence is to be accounted for by the fact that even if it were adduced, it would not displace the prima facie case. But that always presupposes that a prima facie case has been established; and unless we can see our way clearly to the conclusion that a prima facie case has been established, the omission to call witnesses who might have been called on the part of the defendant amounts to nothing."

145. Brooke LJ then cited Gillard J in *O'Donnell v Reichard* [1975] V.R. 916 in the Supreme Court of Victoria Full Court (the equivalent jurisdiction to the England and Wales Court of Appeal):

> "Looking at the authorities from Blatch v. Archer (1774) 1 Cowp. 63 right up to Earle v. Eastbourne District Community Hospital [1974] V.R. 722 , it may be accepted that the effect of a party failing to call a witness who would be expected to be available to such a party to give evidence for such party and who in the circumstances would have a close knowledge of the facts on a particular issue, would be to increase the weight of the proofs given on such issue by the other party and to reduce the value of the proofs on such issue given by the party failing to call the witness."

146. Brooke LJ also cited Lord Lowry in *R v IRC ex p T. C. Coombs & Co.* [1991] 2 A.C. 283 at p.300:

> "In our legal system generally, the silence of one party in face of the other party's evidence may convert that evidence into proof in relation to matters which are, or are likely to be, within the knowledge of the silent party and about which that party could be expected to give evidence. Thus, depending on the circumstances, a prima facie case may become a strong or even an overwhelming case. But, if the silent party's failure to give evidence (or to give the necessary evidence) can be credibly explained, even if not entirely justified, the effect of his silence in favour of the other party may be either reduced or nullified."

HMRC'S ARGUMENTS

147. HMRC's primary case was that DMC *knew* that the Purchases were connected with fraudulent evasion of VAT; in particular that Mr Talati knew that the Purchases he managed (the great majority of them) were connected with fraudulent evasion of VAT; and where the identity of the DMC member of staff who managed a particular Pricemo or Blue Arrow Purchase cannot be ascertained, whoever did manage it actually knew that it was connected with fraudulent evasion of VAT. HMRC submitted that the state of knowledge can be inferred from all the circumstances.

148. HMRC's alternative case was that DMC *should have known* that the Purchases were connected with fraudulent evasion of VAT - because there was no other reasonable explanation for them.

149. HMRC said that they did not assert that DMC itself was fraudulent, dishonest, or a co-conspirator in a fraud; their case against DMC was limited to its state of knowledge.

HMRC's core case: Purchases part of a wider scheme to defraud the revenue that included key features of 'MTIC fraud'

150. HMRC's core case was that the evasion of output tax by Bryanswood (with Vision's cooperation), Pricemo and Blue Arrow – an agreed fact in the case – was but one part of a wider scheme to defraud the revenue; and that this wider scheme was 'MTIC fraud' rather than simple missing trader fraud, or 'acquisition fraud' (as those two types of fraud are described, and differentiated, in the extracts from two First-tier Tribunal decisions in Appendix 1 to this decision - *Electrical Environmental Services Ltd v HMRC* [2014] UKFTT 129 (TC) and *CCA Distribution Ltd (in administration) v HMRC* [2020] UKFTT 222 (TC)).

151. It followed that the wider scheme contended for by HMRC had the following two critical features:

(1) The VAT credit arising from DMC's on-sales to EU customers was critical to the wider scheme.

This feature derives from the fact that the point of 'MTIC fraud' is to obtain payment of the VAT credit from HMRC consequent upon a zero-rated sale at the end of the UK transaction chain.

(2) The Purchases and on-sales of Goods by DMC did not occur in a genuine market.

This feature derives from the key distinction between simple missing trader fraud, or 'acquisition' fraud, and MTIC fraud, as explained in *Electrical Environmental Services* at [5] and [6]:

> "[Acquisition] fraud has a natural limit. It requires the identification of genuine buyers prepared to buy stock, so the need for genuine market demand limits the possible extent of this fraud …
>
> [MTIC fraud] dispenses with the genuine market: the defaulter creates an artificial market. Therefore, a genuine market does not limit the extent of the fraud: on the contrary, this fraud can be committed as often as the fraudster desires – at least until suspicions are raised.

HMRC submitted that, for a simple acquisition fraud to work in any market, the volume of goods to be supplied by the fraudulent VAT evader has to be proportionate to the size of the actual market into which he is selling.

HMRC argued that the market into which the fraudulent VAT evaders were selling in this case was the UK customer-base of DMC's Distribution business; and the size of that market was about £6 million per year. This, HMRC argued, was too small for the fraudulent VAT evaders behind Pricemo, Blue Arrow and Bryanswood/Vision, as they sold DMC about £12 million of Goods over 2½ years.

152. The facts in this case, HMRC contended, supported the making of the following findings (which would in turn support a finding that there was a wider scheme to defraud the revenue with the two critical features above):

(1) a finding that DMC was told by a third party (the organisers of the wider scheme) who to buy the Goods from, who to sell them to, and at what price. Such a finding would reflect the critical nature of DMC's role in the wider scheme for which HMRC contended (as the person claiming the VAT credit arising on the on-sales of the Goods). HMRC submitted that, if the Purchases formed part of the kind of wider scheme for which they contended, the scheme organisers would not have allowed an "unknowing" trader to enter the arrangement and trade on an independent basis, as such a trader could potentially disrupt the flow of goods and monies;

(2) a finding that the Purchases and on-sales took place in an artificial market in the Goods engineered by the scheme organisers; and

(3) a finding that the pricing of the Purchases and on-sales did not reflect commercial factors but rather reflected the roles of the parties in the wider scheme to defraud the revenue (such that a "broker", who took risk on the VAT credit being disallowed, was given a greater share of the profit that, say, a "buffer", that took little risk).

We shall refer in what follows to findings of that kind just described as "**findings of non-commerciality**".

153. HMRC submitted that a "carousel fraud" is a variant of MTIC fraud (it is so described in *Red 12 Trading Ltd v HMRC* [2010] STC 589 at [7]); but an absence of circularity in the supply chain for the Goods does not prevent the scheme in this case from being MTIC fraud.

154. HMRC argued as follows as to how Bryanswood, Pricemo and Blue Arrow acquired the Goods:

(1) Whilst there was no evidence of where Bryanswood acquired the Goods from, HMRC submitted that the only proper inference is that it acquired them VAT free as, if it did not, there was no purpose to the fraud, since Bryanswood would have had to have paid out the very VAT that it was trying to defraud the revenue of. UK VAT monies were diverted away from Bryanswood by the payments made by Vision to the account of IPVDX (Escrow) Ltd at Societe Generale Bank in Cyprus. That ensured both that Bryanswood did not have it in any account to be frozen, and that the monies were out of the jurisdiction.

(2) A similar analysis applies to the Pricemo and Blue Arrow Purchases. There was no evidence of who the suppliers to these companies were, but HMRC submitted that it was telling that when Blue Arrow entered liquidation it owed significant amounts to predominantly non-UK EU companies.

155. HMRC's case was if the Tribunal were to conclude that the Purchases were part of a wider scheme to defraud the revenue of the kind for which they contended, then either it could be inferred that DMC *knew* that the Purchases were connected with fraudulent VAT evasion; or, if not, DMC *should have known* this, as the circumstances permitted of no other reasonable explanation. They cited First-tier Tribunal decisions where the tribunal found that there was an overall, or orchestrated, scheme to defraud the revenue and made inferences from this: *Tower Bridge GP Ltd v HMRC* [2019] UKFTT 176 (TC) at [1411] – [1419] and *CF Booth Ltd v HMRC* [2017] UKFTT 813 (TC)) at [318] – [320].

Facts which HMRC said supported findings of non-commerciality

156. HMRC argued that the following facts of this case supported making findings of non-commerciality:

(1) The **number and amounts of Purchases**: the sales achieved by Pricemo, Blue Arrow, and Vision, effectively from a standing start, were said to be commercially inexplicable; those companies would not have been able to fund the individual purchases of Goods themselves, given their weak credit.

(2) The **consistency of the transaction chains**, especially as regards the Vision Goods: Bryanswood – Vision – DMC – Item/Printberry.

(3) The **speed with which the Purchases and on-sales were made**: the fact that DMC was able to source exactly the quantity and specification of Goods required by its customer was said to be indicative of contrived dealing, as was the fact that the transactions occurred at speed.

(4) **Suppliers were paid early, and in excess of credit limits**: the fact that DMC paid for Goods prior to

(a) the 5 days' credit recorded in the "Approved Supplier" forms for Vision and Blue Arrow;

(b) the 30 days stated on Pricemo's invoices; and

(c) the date shown in its purchase ledger transaction record as the due date;

and/or the fact that DMC agreed shorter credit periods with the suppliers of the Goods than it did with other suppliers. HMRC submitted that DMC's payments for the

Purchases were made more quickly than those made for other purchases made by the Distribution business.

HMRC submitted that DMC's usual procedure (payment only to be made at the end of the agreed credit terms) was circumvented in relation to the suppliers of the Goods, such that payments were routinely made before expiry of the period of credit.

(5) No written terms and conditions from suppliers (apart from "retention of title" wording on invoices)

(6) **Suppliers' source of Goods unknown**: the fact that DMC had no information about the supplier's source of the Goods when it agreed to purchase;

(7) **End-user of Goods unknown**: the fact that DMC had no information about the end-users, or retailers, who acquired the Goods after they were on-sold to DMC's customers;

(8) The **excessive length of the transaction chains**: it appears the supply chain comprised of (at least) the following five parties between the manufacturer and the retailer:

[Manufacturer] – 1. [authorised distributor] – 2. [x] – 3. [supplier to DMC] – 4. [DMC] – 5. [DMC's customer] – retailer.

HMRC argued that rational economic entities in such chains would work to disintermediate parties from the chain and thereby make more profit; and there was no apparent information asymmetry in the printer consumables market that would prevent such disintermediation.

(9) **Consistency of the prices** at which the Goods were Purchased and on-sold: these appear to have been relatively consistent over a long period of time and produced relatively consistent mark-ups where they can be seen. Regarding the Vision Goods, DMC's average mark up was 5%, Vision's was around 1%.

(10) **Amount of DMC's profit** on the Purchases and on-sales: HMRC said that DMC's average mark up of 5% on the Vision Goods was more than it would have received on a commercial basis for the role it played (thus supporting HMRC's case was DMC was being rewarded for taking risk as the "broker" in the wider scheme). In commercial terms, HMRC submitted, DMC was "making money for nothing": for each Purchase and on-sale, all DMC apparently had to do was pick up the telephone to its supplier and customer, check the Goods and arrange delivery to the customer. Yet for doing so little DMC was able to make a margin of 5%.

HMRC submitted that is the essence of commercial dealing to either add value to goods which are being resold, or add value in some other way. If there is neither a physical change to the goods or their description, nor an ability to find a market of which others are not able to become aware, it is hard to understand how one could so easily and repeatedly make such an easy margin for such a period of time.

Where profits are so large by reference to the work done, one would expect purchasers to push harder to reduce the overall percentage profit.

If DMC was seeking its own trades within an active marketplace, then evidence of the systems it used and records of its comparison of competing suppliers would be capable of being produced. Any business in DMC's position would have tried to source goods

more directly, cutting out the middlemen and seeking sources of goods closer to the manufacturers or approved distributors. Equally, DMC ought to have sought to market more closely to end users to reduce middlemen and increase its profits.

(11) There was **little documentary evidence of negotiation** between DMC and its counterparties in the Purchases and on-sales. The fact that Vision made a mark-up on its purchases from Bryanswood and sales to DMC of only 1% shows that that Vision did not negotiate the Vision Purchases with DMC.

(12) **Best prices**: the fact that Mr Cook, in a meeting with HMRC, described the prices for the Blue Arrow Goods as the best DMC could find.

(13) The fact that the large part of the **Goods was on-sold to EU customers**.

HMRC acknowledged that the Pricemo Goods Purchased in the second period (October 2014 – January 2015) were on-sold to UK buyers; but they pointed to the fact that this was after HMRC began enquiring into Pricemo's VAT affairs - and just before Pricemo was deregistered for VAT (1 November 2014). HMRC submitted that, after this, it no longer suited the aim of the scheme organisers to have DMC making VAT credit claims and thus potentially bringing itself to the attention of HMRC, when it would be so easy for HMRC to establish that DMC had been purchasing directly from Pricemo as a deregistered trader. Instead, the second period of Pricemo Purchases were smaller in scale and all on-sold to UK customers (which would be less likely to generate scrutiny by HMRC).

HMRC said the fact that some Blue Arrow Goods were sold to UK buyers does not detract from the pattern of the majority of the transactions. Whilst the aim may have been for all of the Goods to be exported and to generate a VAT credit, even fraud can be imperfect.

(14) **Steep growth of "export" side of the business**: the fact that the "export" side of the Distribution business increased turnover from £9.5 million in the year ended 31 March 2014, to £15.9 million in the year ended 31 March 2017: an increase of 67% over three years. This led DMC to make its largest ever VAT credit claims in the 5/16 and 8/16 VAT quarters.

(15) **Suppliers unknown**: the fact that DMC undertook large Purchases from Pricemo, even though it had no prior course of dealings with Pricemo; and that Pricemo, Blue Arrow and Vision were relatively unknown in the secondary market.

HMRC submitted that a new business in the secondary market for printer consumables would require

> (a) goods to trade, which in turn would require the capital to acquire such goods (including through a line of credit from a financial institution, or credit from a supplier). HMRC submitted that a "new" business with neither repute, nor experience in such trading would not be a good candidate for credit. One would therefore expect to see some other assets available to them, as security for the provider of credit; and
>
> (b) contacts, in this sense of potential suppliers and customers.

(16) **Blue Arrow's poor delivery record**: the fact that Blue Arrow had a poor delivery record; and yet DMC continued to Purchase from it.

(17) **DD procedures not followed**: it was said that DMC carried out substantially less checks on the suppliers from which it purchased the Goods, and on the customers to which it on-sold the Goods, than it did on other suppliers and customers; and that DMC's normal procedures were not followed:

(a) DMC did not follow up on or question inconsistencies between information in suppliers' VAT certificates and shown in Companies House as regards trading activity or bank account details

(b) if credit checks were carried out on the suppliers in the Purchases then they must have been ignored (as they had weak credit ratings)

(c) if the directors of the suppliers were "checked out," the results of those checks must have been ignored. HMRC submitted that none of the directors had a background in the printer consumables trade: Mr Mason of Vision had worked for Kwik Fit (GB) Ltd and Car Parks Ltd; Khalid Rashid of Blue Arrow had worked in a currency exchange.

(d) the Purchases were "waved through" on the basis of DMC's (and, in particular, Mr Talati's) relationships with individuals at the supplier: with Zulfi Khan in relation to Vision, and with Mr Rehman in relation to Blue Arrow

HMRC submitted that no "comprehensive assessment" (the term used in Mr Cook's 21 May 2015 email to a colleague, regarding checks on Vision) was undertaken by DMC in relation to the suppliers in the Purchases. The due diligence amounted to collecting pieces of paper and paying little attention to their contents. The "obvious" questions raised by the limited documents that DMC obtained were not asked. DMC was not concerned about how these small suppliers could have been obtaining Goods of this value on credit.

HMRC submitted that in relation to the suppliers in the Purchases DMC set aside its "robust procedures in place for assessing the suitability of new suppliers" (in the words of Mr Cook's email to Mr Talati of 21 May 2015). HMRC said there was no explanation other than that these procedures were, in some way, circumvented.

Other features of the wider scheme to defraud the revenue, in HMRC's case

Replacement of entities: Vision replacing Lampton, Blue Arrow replacing Pricemo

157. HMRC submitted that those organising the wider scheme were able to replace entities involved in fraudulent VAT evasion, once it appeared that HMRC had discovered them. HMRC pointed to the facts that

(1) DMC's first Purchase from Vision (30 April 2015) came a month after its last purchase from Lampton; and that Lampton was deregistered for VAT from the beginning of June 2015.

(2) Pricemo was deregistered for VAT in October 2014; DMC's last purchase from it was in January 2015; its first Purchase from Blue Arrow was in February 2015.

HMRC submitted that the fact that Lampton and Pricemo could be replaced quickly suggests that those organising the wider scheme had a pool of VAT registered companies that could be brought into play as and when required.

Existence of a buffer company in the Vision chain

158. HMRC submitted that Vision was a "buffer" trader inserted to ensure that DMC, the "broker," had some protection when it made VAT credit claims. They argued that there would be no "buffer" trader in a simple acquisition fraud.

Link between Pricemo/Blue Arrow and Vision

159. HMRC submitted that the links between Pricemo/Blue Arrow, and Vision – essentially through Mr Mayet – indicated that there was an overall scheme that included both supply chains.

Additional arguments as to why DMC knew the Purchases were connected with fraudulent VAT evasion

160. HMRC posed the question of why those fraudulently evading VAT chose to sell Goods to DMC in particular.

161. HMRC rejected the DMC witnesses' explanations - DMC's market reach and reputation, its size and financial stable position - because, they said, on DMC's own evidence, the printer consumables market was accessible to smaller, start-up businesses.

DMC must have "known" because it was an experienced market player

162. HMRC submitted that the fact that DMC was an experienced participant in the market ("nobody's fool", as their counsel put it), indicates that the fraudulent VAT evaders must have told DMC about their VAT evasion: otherwise, HMRC argued, the fraudulent evaders ran a high risk of DMC discovering the evasion and reporting it. HMRC argued that Mr Talati, in particular, must have known about the Purchases' connection with fraudulent VAT evasion – and they pointed to the fact that the terms of Mr Talati's commission incentivised him to maximise gross profit.

Mr Talati "knew" and took advantage of DMC's lax procedures

163. HMRC argued in the alternative, that the fraudulent VAT evaders chose to sell to DMC because they knew that DMC was not "choosy" about its suppliers: it would trade with any registered company; it did not ask questions about the supplier's background or where the supplier got its goods from; DMC's procedures involved little examination of its proposed counterparties, and there was little risk of discovery of a supplier's fraudulent VAT evasion.

164. HMRC argued that Mr Talati took advantage of DMC's lax due diligence and payment procedures, and of the fact that his judgement was highly trusted by his superiors. The fact that the Goods were checked in DMC's warehouse does not prove that DMC did not know of the connection with VAT evasion: for Mr Talati to have tried to circumvent such checks would have been too much of a "red flag".

A large proportion of the Distribution business' purchases were connected with evasion

165. HMRC submitted that the large proportion of DMC's total purchases that were connected with fraudulent VAT evasion, points to the conclusion that DMC knew of that connection:

(1) The Purchases in the two-year period from VAT quarter 11/14 to 8/16 inclusive cost just over £13 million.

(2) For the years ending 31 March 2015, 2016 and 2017, the DMC Distribution business' average annual purchases were just under £20m.

(3) Therefore, on these figures, about a third (by value) of the Distribution business' purchases during that two-year period were connected with fraudulent VAT evasion.

(4) Also, Vision was DMC's second largest supplier by value in the years ended 31 March 2016 and 2017.

Important to the Distribution business to return to level of sales in year ended February 2012

166. The Distribution business' turnover was £21.8 million in the year ended February 2012; it then fell by about a third in the next year, that ended February 2013; it then increased over the next few years such that, in the years ended March 2016 and 2017, turnover was at or just above the figure for the year ended February 2012.

167. HMRC submitted that (i) there was a connection between the decline in turnover during the year ended February 2013 and the first Purchase taking place on 14 May 2012; and (ii) it was significant that, over the course of the years when the Purchases took place, turnover recovered to its level in year ended February 2012.

168. DMC's onward sales of the Goods were in the region of £11.7 million to £12 million, an average of £5.85m - £6m for the years ended March 2015 and 2016. This was roughly equal to the approximately £7 million decline in turnover of the Distribution business between the year ended February 2012 and the following year. HMRC submitted that this meant that the on-sales of the Goods were highly important transactions for DMC.

169. In HMRC's submission, the figures show that, absent the Purchases, the turnover of the Distribution business would have remained flat. Furthermore, the figures show that the increase in turnover experienced by the Distribution business was not attributable to its UK arm, but rather the "trade/export" arm, which increased its sales from £9.5 million in the year ended March 2014, to £15.9 million in the year ended March 2017.

170. Looking at gross profit, as opposed to turnover, over the period when the Purchases occurred, the "trade/export" arm of its Distribution business doubled its gross profits, having not quite doubled its turnover. In the year ended March 2017, then, for the first time shown in DMC's records, the Distribution business made more gross profit from its "trade/export" arm, than its UK sales arm.

Important to Mr Talati to achieve gross profit from the Purchases and on-sales

171. HMRC submitted that the Purchases were also important to Mr Talati: the majority of the Purchases, plus DMC's purchases from Lampton, took place in the years ended March 2015 – 2017. At a 5% average margin, DMC's gross profits on the Vision and Blue Arrow Purchases and the purchases from Lampton were about £594,000. Based on his 15% commission, those gross profits entitled Mr Talati to commission of nearly £89,000 - about 37% of Mr Talati's total commission in those three years (£239,527). HMRC submitted that the Purchases were important to Mr Talati, and that he had a motive to complete the Purchases.

Talati brothers' links; connections of Zubair Talati to VAT fraud

172. HMRC submitted that it was "beyond coincidence" that, following the dip in the Distribution business' turnover during the year ended February 2013, Lampton, the company that Mr Talati's brother worked for, started to make sales to DMC in November 2014. HMRC argued that Zubair Talati intended Lampton's supplies to DMC to be of financial benefit to his brother, which, as a matter of fact, they were.

173. HMRC argued that the following were evidence of the brothers' cooperation:

(1) that Mr Talati was named as the reference on DMC's internal ledger for Iteks – and Zubair Talati had arranged sales by Iteks to two UK companies.

(2) that Zubair Talati received several payments, totalling £7,500, from Ebit Distribution Ltd in late 2010, and that in early 2011 DMC received a letter from HMRC concerning that company's VAT deregistration.

174. HMRC submitted that

(1) Zubair Talati's connections to Lampton and Ebit Distribution Ltd, companies that came to supply DMC, and with whom Mr Talati dealt, and

(2) Zubair's connections with other entities engaged with VAT fraud,

were compelling evidence that Mr Talati knew that the Purchases were connected with the fraudulent evasion of VAT.

175. HMRC submitted that it was striking that two companies that were suppliers to Blue Arrow were also DMC customers managed by Mr Talati.

DMC's awareness of the risk of VAT fraud

176. HMRC submitted that the only explanation for the questions HMRC officials asked DMC in their interactions in December 2012 and February 2014, as to whether certain transactions had actually taken place, was VAT fraud on the part of the specified supplier (or alleged supplier) to DMC. HMRC submitted that, as a result of these interactions with HMRC officials, DMC was well aware of the risk of VAT fraud at the time of the Purchases and was specifically aware of MTIC fraud from at least February 2014. Hence, HMRC submitted, Mr. Cook did say that he knew about MTIC fraud at the meeting with HMRC on 5 July 2016.

Attribution of knowledge to DMC

177. HMRC asserted that the state of knowledge of those directors and senior employees who managed the Purchases and on-sales of Goods is attributable to DMC by the ordinary principles of attribution of knowledge to companies. Where DMC did not identify the individual(s) managing the transaction, HMRC submitted that the knowledge of such individual(s), whoever they were, could be attributed to DMC under such principles.

CE Logistics Ltd

178. HMRC submitted that CE Logistics Ltd is a case in point as to why commercial entities are interested to see that their suppliers have the financial wherewithal to enter into the proposed transactions: HMRC suggested that the most likely explanation for the gulf between CE Logistics Ltd's credit limit of £100,000 (per Mr Kelly's evidence), and the much larger deals it undertook, was its involvement in criminal activity.

HMRC's case as regards dishonesty

179. HMRC submitted that it did not have to, and did not, plead dishonesty as against the parties whose transactions they claimed formed part of the "overall scheme". In particular as regards Item and Printberry - DMC's customers in a large number of the on-sales of the Vision Goods - HMRC did not allege that they were dishonest, but did assert that DMC's supplies to them were integral to an "overall scheme".

180. HMRC described DMC's claims for VAT credit as "the lifeblood of the fraud." They said that is a matter of fact, not an allegation of dishonesty, or fraud, against DMC.

Alternative argument – “should have known”

181. In the alternative, HMRC submitted that DMC should have known of the connection between the Purchases and the fraudulent evasion of VAT. The cumulative circumstances presented to it, as summarised below, permitted of no explanation other than connection with fraudulent VAT evasion:

(1) DMC made large and consistent gross profits for doing very little;

(2) DMC did not properly assess its counterparties;

(3) DMC did not apply its usual systems to the Purchases and on-sales; and

(4) DMC failed to ask the most basic questions as to why it was participating in the Purchases and on-sales.

182. Mr. Kelly said in his evidence as regards the Vision Purchases:

> “The fact that Vision itself was new to the industry did not bother me. Businesses have always come and gone…What mattered about Vision was that Zulfi was on board and arranging the deals and Aziz had done enough business with Zulfi to regard him as a credible player.”

183. HMRC submitted that Mr. Kelly’s evidence shows why, if DMC did not actually know that the Purchases were connected with VAT fraud, it was a perfect target for fraudulent VAT evaders, as DMC appeared uninterested in

(1) what commercial entity it was dealing with.

(2) discovering that Vision’s director was appointed less than three weeks before the first Vision Purchase.

(3) discovering that Vision’s director had no background in printer consumables.

(4) the fact that Vision had a weak credit rating and few tangible assets.

(5) the fact that Vision had not traded prior to dealing with DMC.

(6) why Lampton, the last company that Mr Khan worked for, had suddenly stopped trading.

(7) that Vision had no website.

All that mattered, it seems, was that DMC had done €1.4 million of business with Zulfi Khan over four months (when he was at Lampton); and Mr Talati thought, on that basis, that he was a “credible player”.

This, HMRC submitted, was poor due diligence on Vision as a new supplier.

184. HMRC submitted that it was obvious that Vision did not have either the financial wherewithal, or repute, to have entered the secondary market for printer consumables with a deal worth more than €250,000 on which it had apparently got credit. No commercially rational business would have offered Vision such substantial credit. Further, Vision was apparently able to secure goods at prices that, despite all its years in the industry, DMC could not. DMC does not appear to have questioned where Vision was obtaining the Goods from.

185. HMRC submitted that it was obvious that DMC’s Vision Purchases could not be explained by ordinary commerce.

HMRC's points on the evidence

General points

186. HMRC submitted that DMC produced little or no contemporaneous documentation in support of its case as to how the Purchases and on-sales took place, and what enquiries were made about the relevant counterparties at the time.

187. HMRC submitted that DMC produced no documentary evidence of other "normal" transactions and suppliers, such as transaction documents, ancillary contemporaneous documents, due diligence documents and other documents relevant to these counterparties. The Tribunal is therefore left with only the credibility of DMC's claims as to the similarity of these transactions with others. HMRC submitted that in key instances DMC witness evidence was that the dealings with these suppliers were, in fact, unusual: HMRC pointed to Mr Cook's evidence that the early payments to the three suppliers (compared with DMC's standard terms of payment in 30 days) was not "normal" terms (although, in Mr Cook's words, "not uncommon").

188. HMRC submitted that the lack of contemporaneous documentary corroboration for large parts of DMC's witness evidence creates the difficulty described by Arden LJ in *Wetton v Ahmed* [2011] EWCA Civ 610 at [14]: a judge is entitled to assess the credibility of a witness's oral evidence by reference not only to contemporaneous documents but also by reference to the absence of those documents. HMRC submitted that this is just as important in respect of the documents to support DMC's case that transactions other than the Purchases and on-sales bore many of the same features – and no such documents were produced by DMC. HMRC also cited the observations of Leggatt J in *Gestmin* and Lewison J's assessment of the credibility of the two main witnesses in *Painter v Hutchison*.

189. HMRC pointed to *EDC Ltd v HMRC* [2019] UKFTT 211 (TC), where the First-tier Tribunal was concerned, in assessing the credibility of a witness, to note that he added new material that had been neither part of his case, nor in his witness statements (at [29]). The Tribunal was faced with some lack of documentation, and conflicting witness evidence. The Tribunal said at [29]:

> "Where Mr Chhatwal's evidence conflicted with that of other witnesses, we have preferred the evidence of those other witnesses. Where it is unsupported by documentation, we have considered whether it is credible in the context of the available documents and our other findings of fact. That approach is, of course, also consistent with the more general advice given by Leggat J in *Gestmin*, and by Bingham J in the article cited above."

190. HMRC submitted that DMC's main witnesses, who were involved in the transactions, their supervision and the associated due diligence, were generally not credible on the matters of importance. Further details emerged in cross examination, that had not been said in witness statements. HMRC argued that this showed that the witnesses had no detailed account that would withstand scrutiny to give at the time they made their witness statements, and, at the hearing, sought to embellish, add colour, and provide new details and comparators.

Points on Mr Kelly's evidence

191. HMRC submitted that Mr Kelly's oral evidence included many matters and details that did not feature in his witness statements. For example, CE Logistics Ltd was mentioned in just a single line in Mr Kelly's witness statements but was mentioned several times in his oral evidence (as a comparator to the Purchases).

192. Moreover, Mr Kelly did not, when making those references, inform the Tribunal of Mr McGregor's conviction in 2019 for conspiracy to produce illegal steroids during the period 2009-2015: that information only came before the Tribunal on the following day of the hearing when HMRC produced documentation in relation to it, with the Tribunal's permission. This, HMRC submitted, has bearing on Mr Kelly's credibility overall.

193. In cross examination, Mr Kelly initially disagreed with the proposition that, most of the time, he had either heard of or knew the people he worked with in the market, at the start of their interaction – he attributed this to fact that the market was large – pan-European or pan-global. Later, when reminded that in his witness statement he said "most of the time we had heard of or knew the business or people that worked in it before we started dealing with them", Mr Kelly tried to reconcile his statements, saying that in the recent past, his best deals had been with those he had not known before.

Points on Mr Talati's evidence

194. HMRC submitted that Mr Talati, in particular, was not a credible witness. He was, by turns, argumentative, evasive, sought to answer questions by asking his own, made "speeches" of tangential relevance in response to simple questions, provided new evidence in his oral evidence, was contradicted by the documentation, contradicted his own witness statement and contradicted the evidence of others.

195. HMRC submitted that Mr Talati's evidence included many matters and details that did not feature in his witness statements. For example, Mr Talati in his oral evidence suggested that the reason he had sold the Goods to customers outside of the UK was because he wanted to avoid the manufacturer finding out. That explanation was not given in Mr Talati's witness statement and was contradicted by evidence that DMC commonly sold to UK customers.

196. HMRC said there was inconsistency between

(1) Mr Talati's evidence that, in the immediate aftermath of HMRC's letter to DMC of 4 August 2016 stating that the Vision Purchases commenced with a defaulting trader, he had "been told to stop trading, but did not understand why. I felt like I had been left out to dry. I had very unhappy contacts that wanted to know why DMC had stopped trading and there was not much I could say. I was unable to earn any commission as I was not trading"; and

(2) the fact that Mr Talati attended, with Mr Cook, a meeting with Zulfi Khan during August 2016, at which the issue of Vision's connection to fraudulent VAT evasion was discussed.

HMRC argued that Mr Talati was attempting to minimise his knowledge of what had happened. This, HMRC submitted, was evidence that he knew that the Purchases had been connected with fraudulent VAT evasion.

Points on Mr Cook's evidence

197. HMRC submitted that the DMC's witness statements were, in general, lacking in detail: Mr Cook, for example, did not refer in his witness statement to any follow up actions to his emails of 21 May 2015 regarding document checks on Vision; he suggested in his oral evidence that the reason he did not give these details was that he had a lot of documents to go through in preparing his witness statement (although very few documents were produced in relation to the Vision Purchases, apart from invoices); under cross-examination, he could not recall whether or not follow up actions were taken; and he struggled to explain why the 21

May 2015 emails were sent, if DMC had already become comfortable with buying from Vision, based on the strength of relationship with Zulfi Khan.

198. HMRC submitted that statements made by Mr Cook at the meeting with HMRC on 16 August 2016 about DMC's relationship with Vision, were damaging to Mr Cook's credibility. HMRC's notes of the meeting said:

> "Traders were asked how Vision Sourcing was identified as a major supplier to DMC of printer ink and cartridges which DMC could not source from manufacturers or major distributors in the UK. Mr Cook responded that though, Vision Souring [sic] is a young company, DMC have worked with the director over many years through a previous supplier. Mr Cook advised further that, the director of Vision Sourcing branched out to set up his own business and DMC were happy to carry on trading with him as they have known him over many years."

HMRC submitted that this was inaccurate: DMC had no prior relationship with Vision's director, Mr Mason. Mr Mason had not "branched out to set up his own business" from a previous supplier. Even if Mr Cook was referring to Zulfi Khan, DMC had not known him "over many years"; it had done business with him over the four-month period in which Lampton made supplies to DMC (November 2014 to March 2015).

199. HMRC submitted that Mr Cook's credibility was damaged by the fact that in his oral evidence he said that Vision's importance as a supplier to DMC was small; in fact, Vision was the second largest supplier to DMC's Distribution business over the five years ended 31 March 2014 to 2018 (supplying 9% of purchases from the ten largest suppliers), despite the fact that it only made supplies to DMC for two years.

Further point on the evidence of Mr Hill, Mr Kelly and Mr Talati

200. Mr Talati disclosed in cross-examination that he had been disqualified for two years from acting as a company director for not meeting his legal responsibilities when a director of his prior employer, Fender Group Limited, which went insolvent in 2009 and was dissolved in 2011. HMRC submitted that this damaged the credibility of the evidence of the three witnesses who knew of Mr Talati's disqualification but did not mention it in their witness statements: Mr Kelly, Mr Hill and Mr Talati himself.

Adverse inferences

201. HMRC submitted that the Tribunal should draw an inference adverse to DMC for its failure to call witnesses from any of its trading counterparties to support its case on the facts.

202. HMRC submitted that in the absence of contemporaneous documentation recording the formation of the trading relationships, and negotiation of transactions, between DMC and its counterparties in the Purchases and on-sales, it was incumbent upon DMC to call evidence from witnesses who could make good its assertions as to the commerciality of those relationships and negotiations. HMRC appeared to accept that DMC would not call as witnesses the companies that DMC accepted were involved with fraudulent VAT evasion (Pricemo, Blue Arrow, Bryanswood and Vision), but HMRC suggested that DMC might have called evidence from the customers who bought the Goods. They said the Tribunal would have to assess any explanation put forward by DMC as to why it has not called the witnesses in respect of whom HMRC seek inferences.

203. HMRC submitted that it was not open to themselves to call such witnesses, due to the basic principle that a party cannot call a witness simply to impugn his evidence.

204. HMRC said that if the Tribunal is satisfied that there is a prima facie case that DMC knew that the Purchases were connected with fraudulent VAT evasion, then the Tribunal can, if no proper reason has been given for the absence of key witnesses, draw the inference that DMC feared that if they were brought to give evidence they would have exposed that DMC knew that the Purchases were connected with fraudulent VAT evasion.

DMC'S ARGUMENTS

205. DMC argued that it – through its directors and managers, who gave evidence at the hearing – did not know of the connection of the Purchases with fraudulent VAT evasion. It was also clear from its case that it claimed not to know at relevant times of the "behind the scenes" information about Pricemo, Blue Arrow and Vision/Bryanswood (and Mr MacGregor) as found at the following paragraphs:

(1) [16-17] (Bryanswood and the fraudulent VAT evasion)

(2) [55-56] in respect of Pricemo's VAT affairs

(3) [58] in respect of Mr Khalid's tax records

(4) [59-60] in respect of Blue Arrow's VAT affairs

(5) [62] in respect of Blue Arrow's creditors

(6) [69] in respect of Vision's 1% margin

(7) [72] in respect of Mr Mason's tax records

(8) [73] in respect of Vision's VAT affairs

(9) [75-77] (Bryanswood)

(10) [85] in respect of Item's other suppliers

(11) [90] in respect of Lampton's VAT affairs

(12) [91-93] (Lampton)

(13) [95-100] (Lampton and various linkages)

(14) [102-104] (various linkages)

(15) [106] (Mr MacGregor)

206. DMC's position was that the reason it neither knew, nor should have known, of the connection to fraudulent VAT evasion, was that Purchases and on-sales of the Goods were standard, workaday transactions which one would expect to find in the secondary market for printer consumables.

207. DMC said that the fraudulent VAT evasion with which the Purchases were connected was in the nature of 'acquisition' fraud. As for there being an "orchestrated" scheme, DMC noted that the linkages pointed to by HMRC were between suppliers to DMC and others involved in fraudulent VAT evasion (rather than linkages with the customers involved in the on-sales of the Goods).

208. DMC argued that its lack of awareness of VAT fraud in the secondary market for printer consumables at the relevant times is relevant to the reasonableness of the steps it took to verify the legitimacy of its transactions and the inferences to draw from the circumstances surrounding the Purchases and on-sales of Goods.

209. DMC argued that its taking out of credit risk insurance from Euler Hermes (and the costs of this) is inconsistent with the suggestion that DMC was not at commercial risk due to this being "directed trading".

210. DMC argued that its due diligence procedures catered to the known commercial risks at the time – such as suppliers failing to deliver the goods required, or customers failing to pay – but they did not cater for risks that DMC was not aware of, such as MTIC fraud risk (and, indeed, the risk of input tax being disallowed on *Kittel* principles).

211. DMC submitted that HMRC's case on "actual" knowledge had "retreated" to an allegation that Mr Talati alone – and not the other DMC witnesses – knew that the Purchases were connected with fraudulent VAT evasion.

FURTHER FINDINGS OF FACT

Approach to DMC witnesses' evidence

212. In this part of the decision we make findings of fact on evidence that was heavily contested. Much of this evidence was in the form of witness statements and oral evidence of the DMC witnesses (Mr Kelly, Mr Talati, and Mr Cook in particular; Mr Hill and Mr Bruce to a lesser extent) concerning ordinary commercial practice for DMC's Distribution business. It was DMC's case that such evidence could be relied on

(1) as a comparator to things done in relation to the Purchases and on-sales of Goods (where the doing of such things was not itself a contested matter – what was contested was whether it was ordinary commercial practice to do such things); and

(2) in some instances, to show how the Purchases and on-sales of Goods, themselves, were carried out (because, according to the DMC witnesses, the practices were basic to the carrying out of the business and therefore were followed in every transaction).

This evidence was, for the most part, not corroborated by contemporaneous documentary evidence.

213. HMRC's case was that such evidence could not be relied on as (i) the evidence was not corroborated by contemporaneous documentary evidence, (ii) the witness involved was generally not credible, and/or (iii) adverse inferences should be drawn from the absence of evidence from transactional counterparties and/or documentary evidence of comparator transactions.

214. As will be seen in the findings that follow, we have concluded that, in a number of specific instances, the DMC witnesses' evidence is to be relied on, on the balance of probabilities. Before making specific findings, however, we first set out, in a generic fashion, our thought process when deciding, in specific instances, that such evidence could be relied on (so that, in our findings that follow, we do not have to repeat our generic reasons – we simply use the phrase "based on the DMC witnesses' evidence" and add comments where particular aspects of the evidence seemed to us relevant in making any particular finding).

Paucity of corroborating documentary evidence

Paucity of corroborating documentation re: Purchases and on-sales of Goods

215. When considering the paucity of contemporaneous documentary evidence as regards the Purchases and on-sales of Goods – we had over 2,000 pages of "deal packs", containing invoices, delivery notes and the like, but little in writing as regards the negotiations leading up to those transactions – it seemed to us relevant to consider whether material corroborating

evidence was in existence at the time the parties were preparing for the hearing of the appeal. DMC's evidence was that it was not, given that:

(1) negotiation of the Purchases and on-sales with suppliers and customers was conducted orally to a significant extent; and what was reduced to writing was largely done on email; and

(2) DMC had an email elimination policy under which employees were instructed to delete permanently all emails other than those considered "important" ("documents of record", such as purchase orders, invoices and warehouse records, were not affected by this policy).

216. HMRC queried whether or not contemporaneous documentary evidence of the Purchases and on-sales of Goods existed: they suggested that that DMC's witnesses did not adequately explain the searches for contemporaneous documents undertaken by DMC; they asserted that it was "highly unlikely" that none of Mr Talati's emails survived, when the last of the Purchases was in August 2016; and that the lack of Mr Talati's emails may be connected to the fact that he worked from home.

217. We found DMC's explanation of the reasons for the paucity of documentary evidence relating to the Purchases and on-sales, other than invoices and the like, to be credible on the balance of probabilities, as it was

(1) supported by an example of an internal email explaining the email deletion policy;

(2) consistently made by the DMC witnesses, whom we found to be credible on this point;

(3) inherently plausible in our view: a policy of permanently deleting emails is not uncommon in business; and

(4) as applicable to Mr Talati's emails as to any other DMC emails; we were not persuaded, on the balance of probabilities, that Mr Talati's working from home (like several other DMC employees) had any bearing on whether and when his emails were deleted under DMC's email deletion policy.

218. As a result, when assessing the DMC witness' evidence concerning matters relating to the Purchases and on-sales of Goods (such as how they were negotiated), we did not "discount" their evidence on grounds that it was not corroborated by contemporaneous emails; and where we have made findings in what follows on such matters based on the DMC witnesses' evidence, it was in general because such evidence:

(1) accorded with what little contemporaneous documentary evidence there was before the Tribunal; in this respect, the 2015-16 email exchanges between Mr Talati and Mr Haider of Item (reproduced at Appendix 2), preserved because they were given to HMRC in an exchange of information with the Austrian tax authorities, were, in our view, an important piece of evidence;

(2) was consistent across the DMC witnesses, including those, like Mr Cook and Mr Talati, who no longer worked for DMC or its successor as regards the Distribution business; and

(3) accorded with what the Tribunal considered basic business common sense.

Paucity of corroborating documentation re: ordinary commercial practice in the Distribution business

219. In assessing whether to make findings as to ordinary commercial practice in DMC's Distribution business based on DMC witness evidence uncorroborated by contemporaneous documents, we bore in mind the following:

(1) the extent to which this was not evidence of particular conversations or meetings, but rather evidence of a more general nature about how a certain kind of business was ordinarily conducted over an extended period of time; the fallibility of human memory no doubt remains a factor in assessing such evidence, but, in our view, a less important factor if what is being remembered was commonplace business practice over an extended period; of course, in making this point (and the one which follows), we have regard to whether the individuals giving the evidence are neutral, or have an interest in the outcome of the case;

(2) in some instances, evidence of "ordinary practice" in business, or of how a particular business market operated, is more effectively and reliably conveyed by individuals who have spent large parts of their careers in that sort of business, than by production of contemporaneous documents; indeed, particularly in small and medium sized businesses, with more limited administrative resources and of a size in which less formal communication remains effective, contemporaneous documents effectively conveying this sort of information may not exist;

(3) documentary evidence of contemporaneous comparator transactions (such as DMC's dealings with other suppliers) would be subject to the same problem of lack of contemporaneous emails as affects the transactions in issue; invoices and other formal records could have been produced but, like the "deal packs" for the transactions in issue, would not in our view have shed meaningful light on the points in issue in this appeal;

(4) whether the evidence was consistent with what little documentary evidence was before the Tribunal, such as statements in DMC's audited, publicly-available accounts;

(5) whether the evidence was consistent across all of the witnesses who were addressing the subject, including the one witness who never worked for DMC, Mr Hastings, and the two witnesses who had once, but no longer, worked for DMC or its successor; and

(6) whether the evidence accorded with what the Tribunal considered to be basic business common sense. We relied on this (and Mr Hastings' evidence as mentioned in (5) above) in particular as a "control" against the personal interest factor mentioned in items (1) and (2) above: we were more prepared to accept evidence of a general practice from a witness who had an interest in the outcome of the case, where we considered the subject matter of the evidence to be a matter of basic business common sense and/or it was consistent with Mr Hastings' evidence on the matter.

Adverse inferences

220. HMRC invited us to make adverse inferences from the fact that DMC did not call as witnesses any of the individuals who worked for the suppliers and customers involved in the Purchases and on-sales, to corroborate DMC's case that those transactions were ordinary commercial business from DMC's perspective. In our view it is understandable why DMC did not call individuals who worked for the suppliers as witnesses, as those companies have

been shown to have been engaged in the fraudulent evasion of VAT, and so the testimony of their staff would be of doubtful credibility (and we understood HMRC to be of the same view). As for customers, we deal with this point at [278] below as part of our making findings related to DMC's margin on the Purchases and on-sales of Goods.

General credibility of the DMC witnesses

221. We did not consider that there were inconsistencies – either with other things in their evidence, or with facts we regarded as uncontested or clearly proven – in the evidence of any of the witnesses before us, for either party, of so serious a nature that it caused us to question, any more than we ordinarily would as an objective fact-finding tribunal, other aspects of their evidence. In other words, we did not have grounds to consider any of the witnesses "generally" non-credible, in the sense of deliberately telling untruths to, or seeking to mislead, the Tribunal. That is not to say, of course, that there were not aspects of their evidence which we did not find reliable enough to support the making of findings of fact on the balance of probabilities; however, that unreliability in specific instances did not, in our view, spill over into generalised non-credibility.

222. As mentioned above in our summary of their arguments, HMRC invited us to find otherwise with respect to some of the DMC witnesses; we now briefly explain why we were not persuaded by the main examples of non-credibility suggested by HMRC:

(1) Mr Kelly and Mr Talati, in answering questions in cross examination, referred to facts not mentioned in their witness statements – in particular, to other transactions which they put forward as comparators with the Purchases and on-sales of Goods, generally with the aim of showing that the Purchases and on-sales were within the parameters of ordinary commercial practice. This matter did not cause us to have material concerns about these witnesses' general credibility – in our view, they were tending during cross examination to give examples that were at the top of their heads at the time, rather than limiting themselves to the examples given in their witness statements. If anything, this tendency on their part indicated the straightforward and, indeed, unguarded manner of their giving oral evidence and, in our mind, reflected to some extent their professional backgrounds as salesmen whose manner was to speak "off the cuff" (and, sometimes, at length).

(2) Leading on from the point just made, Mr Kelly referred several times in cross examination to DMC's purchases from CE Logistics Ltd – the Distribution business' largest supplier in the years in question, but not much referred to, specifically, in the DMC witnesses' statements. This was mainly in the context of Mr Kelly giving, as a comparator with the Purchases, an example of a major supplier which had approached DMC out of the blue and did not have a strong balance sheet. Mr Kelly did not, however, mention the information, which he knew at the time of the hearing, that the director of CE Logistics Ltd, Mr MacGregor, was convicted in November 2019 of conspiracy to produce Class C controlled drugs (illegal steroids) during the period 2009-2015 – this information only emerged on the following day of the hearing, when (with our permission) HMRC introduced it in evidence, having done some research. This incident did not cause us to have serious concerns about Mr Kelly's general credibility – he had not said something untrue and there was no suggestion that Mr Kelly was in any way involved with, or knew about, Mr MacGregor's criminal activity at the time it was being carried out; and we consider that Mr Kelly had reasonable grounds to consider the information irrelevant to the matters which he was giving evidence, and so was not seeking to mislead the Tribunal.

(3) None of Mr Hill, Mr Kelly or Mr Talati mentioned in their witness statements the fact of Mr Talati's two-year disqualification as a director coming out of the insolvency of the company he worked at (and was a director of) for about a year immediately before joining DMC. The matter came to light only because Mr Talati mentioned it in cross examination as he thought it helped explain a change to his terms of employment by DMC made in 2011. We do not consider that Mr Talati's credibility can be impugned as a result of this incident – he mentioned the point in cross examination in a manner which did not make us think he was trying to "cover up" this fact – the fact that he omitted it from his witness statement was, we consider, simply because it did not consider it relevant. Neither did this incident cause us to have serious concerns about the general credibility of Mr Hill and Mr Kelly: they too, we consider, omitted it from their witness statements as it did not strike them as relevant; although this judgement on their part can perhaps be questioned, it does not cause us to think they were wilfully trying to mislead the Tribunal.

(4) Mr Talati's demeanour under cross examination was somewhat combative, by which we mean he sometimes argued with the cross-examiner's question, at least to begin with, before answering it. Overall this behaviour did not cause us serious concerns as to his general credibility: some people respond this way to forensic questioning which puts to them, for example, that they cannot explain a business transaction which they took part in, or that they are not telling the truth – such behaviour *might* indicate that the person is telling untruths or trying to mislead the Tribunal, but it by no means inevitably does so; and, in this case, we did not find grounds for drawing such conclusions in relation to Mr Talati.

(5) We comment very briefly on other incidents cited by HMRC:

(a) Regarding [193] above: we take from this the difficulty of generalising about whether "most" transactions were with counterparties previously known to DMC: it is clear enough that, in Mr Kelly's evidence (and indeed that of the other DMC witnesses), there were many transactions with counterparties in both categories (both previously known to, and previously unknown to, DMC). We do not consider that Mr Kelly was trying to mislead the Tribunal and so this incident does not cause us to consider him unreliable as a witness.

(b) Regarding [196] above: we do not regard this as a material inconsistency in Mr Talati's evidence: as he was not directly involved in the meetings and correspondence with HMRC over this period, it seems plausible that there was a period a time in which he did not fully understand what was going on and why.

(c) Regarding [198-99] above: it seems reasonably clear that Mr Cook had Zulfi Khan in mind, and did not know (or had forgotten) that he was not a director of Vision; and by referring to a relationship of "years" rather than "months" Mr Cook said something inaccurate at this meeting with HMRC. However, we view this as a one-off lapse rather than part of a pattern of making inaccurate statements such as would give us concerns about Mr Cook's general credibility. As for his describing Vision as "small", this we understood to be in the context of DMC as a whole, and therefore not inaccurate; in any case, it was Mr Cook who provided the information showing that, by sales, Vision comprised 9% of DMC's top 10 suppliers.

Findings related to the market in which DMC's Distribution business operated

223. The Distribution business generated gross profit by buying printer consumables more cheaply than it sold them. The business operated in the "secondary" or "grey" market in printer consumables, so called because the "primary" market was restricted to manufacturers – mostly large, global corporations like Hewlett Packard of the US, and Canon and Epson of Japan – and the "official" distributors appointed by those manufacturers, usually for a designated region or country. Market forces such as over-supply of manufactured products, and differential in prices and supply/demand between regions and countries around the world, had given rise to this "secondary" market in printer consumables, in which goods could trade at prices considerably lower than those in the "official" channels. The secondary market was generally tolerated by the global manufacturers and official distributors – despite the fact that prices in that market could be significantly less than in the official channels - as it helped to get their products sold. The secondary market did, however, operate under what the DMC witnesses, and Mr Hastings, called a veil of "discretion" or "secrecy": the global manufacturers and official distributors did not want to be seen to be undermining their own pricing guidelines, and therefore preferred not to be explicitly linked to a lower-priced secondary market transaction. This meant that the precise manner in which goods entered the secondary market from the official channels was often obscured. The secondary market was unregulated and so had no formal barriers to entry: it offered opportunities for quick-witted traders to take advantage of pricing arbitrage opportunities around the world.

224. We make these findings based on the DMC witnesses' evidence, noting in particular

(1) the consistency between the evidence of the DMC witnesses and that of Mr Hastings, who never worked for DMC and had no connection with the Purchases, but who had worked for many years for two of the large Japanese global manufacturers (as well as, for a short time, Beta Distribution plc, one of the Distribution business' competitors and where Mr Talati had worked for several years earlier in his career);

(2) the inherently plausibility of the evidence: a "secondary" or "grey" market is a known phenomenon in business; and

(3) that a generalised description of this market was not something inherently likely to be found in a contemporaneous document, such that witness evidence of individuals who had spent their careers in the market was an appropriate form of evidence.

New players in the secondary market

225. The DMC witnesses said new and/or small businesses in the secondary printer consumables market were commonplace: the market was unregulated and individuals with a talent for selling and deal-making could succeed on their wits. HMRC argued that this conflicted with DMC's evidence that its experience, reputation and contacts in the market had taken years to build up and gave it a market advantage.

226. We do not see material inconsistency in the evidence here: the fact that DMC benefitted from its experience does not mean that newcomers could not test their abilities in the market. DMC's evidence was consistent that an individual's deal-making abilities, and contacts, were important in the market, whether that individual operated in a "newcomer" business or in one of the "established players": this is why DMC's hiring of Mr Talati in 2009 had been, in Mr Kelly's words, a "high five moment" for DMC's senior management – DMC believed that it had brought in one of the best traders in the market.

227. The point was also made by the DMC witnesses, and supported by Mr Hastings' evidence, that new and/or small businesses played a part in maintaining the "veil of secrecy" around how goods entered the secondary market from the official channels: their presence in a chain of supply made it harder to trace goods back to their original entry into the secondary market – and this "obscurity" was favoured by those in the official channels.

228. We thus find, based on the DMC witnesses' evidence, that the presence of small and/or new businesses in the secondary printer consumables market was commonplace, for commercial reasons.

Did suppliers make first contact with DMC?

229. The DMC witnesses said that suppliers in the secondary market (i.e. those looking to sell rather than to buy) would commonly make first contact with the Distribution business (rather than the Distribution business making the first move, once it had lined up a buyer) – indeed, this is what happened with the Purchases. HMRC submitted that this contradicted a statement by DMC's accountants (a small firm based in Croydon) in a letter to HMRC of 14 September 2016:

> "DMC was not contacted by the seller. DMC had its own customers for particular trades and then sought suppliers who could meet those needs, in order than DMC could supply its customer."

230. We prefer the DMC witnesses' evidence on this point, as it is consistent and inherently plausible, particularly given our findings about the nature of trading in the secondary market in printer consumables: it was an environment given to opportunistic deal-making, and not one where there were fixed rules about which kind of party approached which other kind of party to make a deal.

Findings related to the "export/trade" vs "UK" aspects of DMC's Distribution business

231. We find that DMC's Distribution business had two aspects which operated on slightly different business models:

(1) the "export/trade" business, which involved deal-making in the global secondary market, regularly seeking to arbitrage price differentials between different countries or regions, and so for the most part involved selling to customers outside the UK; in making such "deals", DMC had a commercial interest in matching a sale to a purchase, so locking in DMC's gross profit and minimising the time goods needed to be held in DMC's warehouse; and

(2) the "UK" business, which was geared to a UK wholesaler customer base; it was key to this part of this business that DMC could provide specific products required by the customer at short notice (usually overnight); the sales were thus serviced from goods bought to be held in "stock" in DMC's warehouse. DMC held around 1,000 product lines worth about £1 million in stock in its warehouse. This aspect of the business was not so much "deal" based as based on servicing the needs of a steady customer base. Because it involved goods being held in stock for longer periods, this aspect of the business had higher costs – but (as can be seen from the tables in the next paragraph) it generated generally greater gross profit than the "export/trade" business, by charging more for the goods (which customers were prepared to pay, in return for receiving quality goods consistently at short notice).

The two aspects of the Distribution business could work in tandem: when negotiating a bespoke deal DMC would sometimes take a bigger consignment from a supplier than it had

"matched" with a prospective buyer (and so negotiate a better unit price) – and the excess could then be put into "stock" to service the "UK" business. We make this finding based on the DMC witnesses' evidence, noting in particular its inherent plausibility and alignment with business common sense.

232. The two parts of the Distribution business performed as follows in the years ended 31 March 2014 to 2018; it will be seen that the "export/trade" business was the larger by *volume of sales* (relative proportion was fairly consistently about two/thirds "export/trade", one/third "UK"), but that, in terms of *gross profit*, the proportion moved from about 60/40 in favour of the "UK" business, to about 50/50, over these five years.

Sales (£millions)

Year ending 31 March	**"UK" business**	**As % of whole Distribution business**	**"Export/Trade" business**	**As % of whole Distribution business**
2014	6.2	39	9.5	61
2015	5.8	32	12.2	68
2016	6.4	28	16.4	72
2017	5.7	26	15.9	74
2018	5.6	31	12.8	69

Gross profit (£millions)

Year ending 31 March	"UK" business	As % of whole Distribution business	"Export/Trade" business	As % of whole Distribution business
2014	1.0	63	0.6	37
2015	1.0	61	0.7	39
2016	1.5	62	0.9	38
2017	1.1	49	1.1	51
2018	0.7	47	0.7	53

233. HMRC argued that the following DMC witnesses' comments on the figures above were inconsistent:

(a) Mr Kelly commented that the "UK" part of the business was the more important and the easier to make money from, as it made more gross profit from less sales;

(b) Mr Hill commented that it was harder to gain new customers in the "UK" part of the business and easier to do so in the "export/trade" part of the business.

234. We do not find these comments to be materially inconsistent; rather, they support the slightly different business models between the two parts of the business, as we have found above. In a nutshell, the Distribution business could generate more gross profit in the "UK" business – but this depended on keeping a customer base with specific needs and requirements happy, and involved more costs (which came into the "operating profit" calculation after "gross profit", in the form of "administrative" costs).

Findings related to the Purchases

DMC Distribution business' approach to commercial risk on suppliers

235. Much argument in the case related to the commerciality – or otherwise – of DMC's dealings with the suppliers in the Purchases. We shall go on to make findings on particular aspects of those dealings. However, it will assist if we first make findings as to DMC's approach to commercial risk as regards suppliers to the Distribution business. By "commercial risk", we mean the risk that suppliers will fail to deliver goods in the quantity, of the quality, and at the time, expected by DMC.

DMC's basic approach to commercial risk as regards suppliers

236. We find that DMC's basic approach to such risk was:

(1) to have robust procedures for checking that goods delivered by suppliers were of the quantity and quality that DMC expected; and

(2) not to pay for goods delivered until such checks were carried out.

237. We make this finding based on DMC witnesses' evidence; in doing so, we note that HMRC's case, whilst critical of and querying of many aspects of DMC's dealings with suppliers, did not to the same degree question the robustness of DMC's procedures for checking goods or its practice of not paying until such checks were carried out.

Supplementary steps taken by DMC as regards risk on new suppliers

238. Supplementing the basic approach to commercial risk on suppliers described above, DMC also, for new suppliers:

(1) sought certain documents from the suppliers in order to verify the identity of the supplier legal entity and its directors:

(a) a bank statement;

(b) a VAT certificate (and/or a VAT validation check was carried out on the HMRC system);

(c) residential address of directors;

(d) main telephone number;

(e) directors' email address and telephone number; and

(f) contact details of the supplier's accountants;

(2) ran an online credit check on the new supplier using a system like Creditsafe;

(3) required the supplier to complete DMC's "Approved Supplier" form; this form comprised a declaration by the supplier that it would abide by DMC's terms and conditions; it also had spaces to record credit periods (if different from DMC's standard 30 days), and credit limits, accorded to DMC by the supplier;

(4) placed considerable store on whether DMC had a pre-existing business relationship with an individual at the new supplier: if it did, DMC was prone to give this more much weight than any inconsistencies or oddities in the documents and forms mentioned immediately above. Where there was no such prior relationship, and the new supplier had effectively "cold-called" DMC, DMC would (in the words of Mr Kelly) "start small" and "tread more carefully" with that supplier, until the relationship became established.

(1), (2) and (3) above were the responsibility of DMC's Finance department (rather than the Distribution business), as was the final decision as to whether to engage with a particular new supplier.

239. We make these findings based on the DMC witnesses' evidence as well as documentary evidence in the form of Mr Cook's emails of 21 May 2015 to three of his colleagues in the context of checks made on Vision. We further find, on the same bases, that these supplementary steps described above were carried out as regards Pricemo, Blue Arrow and Vision.

240. In making these findings, we noted that some suppliers to DMC had their own "credit account application forms" which they required DMC to complete, and their own written terms and conditions (an example of this in the evidence were such documents from a supplier to DMC called ECS UK Ltd). We note that such forms are not evidence of DMC's "checks" or "due diligence" on the supplier – rather, they are the supplier providing alternative documentation to DMC's own "Approved Supplier" form. We also had evidence of two Japanese global manufacturers having required DMC to sign up to their "partner reseller agreements". These, again, are not evidence of what "checks" or "due diligence" DMC did, or did not, perform on new suppliers.

Did DMC commonly know the source of its suppliers' goods in the "official" market?

241. The DMC witnesses referred to examples of purchases where the supplier told DMC the source of the goods in the "official" market; for example, an arrangement by which an official distributor could buy the goods cheaply from a manufacturer (because they were for sale to a lower-cost region). HMRC argued that the fact that DMC did not obtain this information about the Goods, was evidence that the Purchases were uncommercial. The DMC witnesses responded that it was by no means always the case that DMC was given this information by suppliers; and usually such information was not given, as this was valuable commercial information for the supplier which they would not want to share with their customer (who might otherwise go directly to the "source" and "cut out" the supplier).

242. We find, based on the DMC witnesses' evidence, that the Distribution business commonly did not know the source of its suppliers' goods in the "official" market, noting in particular the consistency of this finding with our findings about DMC's approach to commercial risk on suppliers; the "veil of discretion" that operated in the secondary market; and the inherent plausibility of this finding as a commercial matter.

Why DMC continued to Purchase from Pricemo and Blue Arrow after poor deliveries

243. We have found that the deliveries of Pricemo and Blue Arrow Goods did not always go smoothly – there were instances of deliveries not arriving on time and of products found, upon inspection by DMC, to be damaged or missing. HMRC argued that it was non-commercial that DMC carried on Purchasing from Pricemo and Blue Arrow after these incidents. We have also found that steps were taken to deal with the problems: Mr Rehman came in for meetings with Mr Kelly and others in the Distribution business to discuss the problems; and, following this, the deliveries returned to a satisfactory standard - and so we find that this improvement in performance was, in essence, why DMC continued to buy from Pricemo and Blue Arrow, despite the earlier problems. We make this last finding based on the DMC witnesses' evidence; in particular, it seems to us that ironing out problems with deliveries was a key commercial concern of the Distribution business: it is consistent, in our view, with DMC's basic approach to commercial risk on suppliers, as we have found it above, in the sense that it shows DMC carefully checked supplies made by Pricemo and Blue Arrow and took reasonable commercial actions when problems arose.

Did DMC, in the Pricemo Purchases, depart from its practice of "starting small" with suppliers with which it had no prior relationship?

244. Pricemo was a "new" supplier from DMC's business perspective, as no-one at DMC had previously worked with Hafeez Rehman; Blue Arrow and Vision, on the other hand, whilst being new to DMC as legal entities, were "known quantities", from DMC's point of view, due to pre-existing relationships with Hafeez Rehman (at Blue Arrow) and Zulfi Khan (at Vision – originating from DMC's relationship with Lampton, for which Zulfi Khan had worked).

245. HMRC argued that DMC's evidence about "starting small" with new suppliers where there was no prior relationship was inconsistent with the facts of DMC's first Purchases from Pricemo: in May 2012, DMC made its four first Pricemo Purchases, each one averaging just over £100,000. DMC's witnesses argued that £100,000 was a relatively small number for the Distribution business. HMRC in turn argued that saying £100,000 was "small" was inconsistent with DMC's management practice of requiring authorisation from DMC senior management (Mr Cook or Mr Hill) for the Distribution business to proceed with deals in excess of £50,000.

246. We do not see material inconsistency between the amount of DMC's initial Purchases from Pricemo and the evidence that DMC started "small" with a new supplier. The reason for "starting small" was to reduce commercial risk – it was to test whether the new supplier could "deliver the goods" in terms of quantity, quality and timeliness. Testing the waters with four Purchases of just over £100,000, in a business of DMC's size, does not strike us as implausible: we note the Distribution business' annual sales were £14.5 million in the year in question, that ended 31 March 2013, making each of the initial Pricemo Purchases around 0.7% of annual turnover; the previous year's sales had been £21.8 million, of which each initial Pricemo Purchase was just under 0.5%. The plausibility is not countervailed by the procedure for involving DMC-wide senior management in deals of the Distribution over £50,000: this had a slightly different commercial purpose – to keep the company-wide managers abreast of what was going on in the Distribution business – and so the £50,000 need not "translate across" to the different considerations in testing a new supplier's ability to "deliver".

247. We therefore find that DMC did not depart from its ordinary commercial practice of "starting small" with "new" suppliers (i.e. those with which it had no pre-existing business relationship), when it came to the initial Pricemo Purchases .

Why the results of DMC's document and online credit checks did not stop the Purchases going ahead

248. HMRC argued that it was uncommercial that the outcomes of the document and online credit checks described above as part of DMC's supplementary steps with respect to new suppliers – assuming they were carried out – did not prevent the Purchases from going ahead. The instances of the outcomes of such checks which, HMRC argued, should have stopped the Purchases proceeding, were as follows:

(1) regarding the backgrounds of the suppliers' directors, and descriptions of their activities in official records, HMRC pointed to

(a) Mr Mason, director of Vision, having worked for tyre-fitting companies;

(b) Mr Patsalides, director of Lampton, being a builder;

(c) Blue Arrow's trade classification being shown as a management consultancy in its VAT certificate;

(d) Blue Arrow's trade description at Companies House being "other personal service activities"; and

(e) Lampton's business activity being described as accountancy in its VAT certificate.

HMRC argued that it was uncommercial of DMC to have engaged with these companies as suppliers. As regards the relevance of Lampton, HMRC pointed to the links between Lampton and Vision, principally via Zulfi Khan working for both, and the DMC's purchases from Lampton ceasing shortly before the first Vision Purchase;

(2) the online credit checks indicated that the suppliers had weak creditworthiness. Whilst acknowledging that DMC did not itself take credit risk on the suppliers (and so to that extent their creditworthiness was not a commercial risk to DMC), HMRC argued that it was uncommercial to buy from a supplier in an amount which that supplier could not itself fund.

249. DMC's witnesses' response essentially was to explain DMC's approach to commercial risk on suppliers, as we have found it above – this approach protected DMC from commercial risk even in the circumstances highlighted, by ensuring that DMC paid only for goods supplied that met its requirements. From a commercial risk perspective, none of the following were considered to be material risk factors:

(1) the professional background of the supplier's directors;

(2) inconsistencies or oddities in the description of the supplying entity's business activities in its legal records;

(3) the supplier's creditworthiness (as DMC did not take credit risk on its suppliers). (It was in this context that Mr Kelly proffered the example of CE Logistics Ltd, being (like the suppliers in the Purchases) a supplier that delivered large values of goods to DMC, but was not itself a strong company financially.)

In addition DMC perceived Blue Arrow and Vision to be relatively low-risk as new suppliers, due to DMC's pre-existing relationship with the individual it was dealing with (Hafeez Rehman from Blue Arrow, through past dealings with Pricemo; Zulfi Khan from Vision, through past dealings with Lampton).

250. When challenged by HMRC as to why, then, DMC bothered with document and online credit checks (as part of what we have found to be DMCs supplementary checks on new suppliers), the DMC witnesses' response was that the essential aim of such checks was modest: obtaining useful basic information and verifying the company's legal existence.

251. We find, based on the DMC witnesses' evidence, that the reason the Purchases went ahead, despite the discrepancies in their documents, their directors' lack of experience, and the outcomes of online credit checks, can be found in DMC's approach to commercial risk on suppliers, as we have found it above. The supplementary checks made by DMC were of relatively minor commercial importance to DMC, in particular, as we found above, where DMC had a pre-existing business relationship with its contact person at the supplier.

Why DMC paid for the Purchases earlier than the documented credit period

252. Many of DMC's payments for the Goods were made before the expiry of the five days' credit period recorded in DMC's "Approved Supplier" forms for Blue Arrow and Vision (and well before the 30 days stated on Pricemo's invoices). HMRC argued that this could not be explained as a commercial matter, given the DMC witnesses' evidence that

(1) DMC's default terms (reflected in its "Approved Supplier" form unless varied by the terms of that form) were to ask for 30 days' credit from suppliers;

(2) it helped DMC's cash position to defer payment as long as possible; and

(3) DMC's general policy was to pay at, but not before, the time agreed with the supplier.

253. DMC and its witnesses responded that

(1) early-payment (i.e. payment following delivery and inspection of the Goods, but in less than five days) had been agreed with the suppliers – but the "Approved Supplier" forms for Blue Arrow and Vision, and the wording on Pricemo's invoices, were not amended to reflect this (and neither was the computerised accounting system, which generally recorded 30 day payment terms); and

(2) early-payment was a commercial negotiating chip that DMC could, and did, use in some circumstances to secure deals and/or build relationships with suppliers; this was particularly the case with smaller counterparties, which tended to value more generous payment terms, in order to keep afloat; given DMC's size, stability, and solvency, early-payment was a "sweetener" that DMC could throw into a deal, in return for commercial advantages to itself in terms of e.g. price or access to future opportunities.

254. We find, based on the DMC witnesses' evidence, that the reason for early-payment for the Purchases, as described above, was that this was something DMC could "give" when negotiating terms with smaller counterparties, given its size, stability and relatively strong current net asset position, as part of an overall package which it considered commercially attractive (of which the key component was price). We note that this finding is consistent with the absence of extensive terms and conditions imposed by the supplier (in contrast with the large manufacturers, which, according to documentary evidence before us, imposed lengthy contractual terms when supplying DMC) – this relative "lightness" of contractual burden on DMC was part of the package of terms with smaller counterparties, like the suppliers in question, that made dealing with them commercially attractive.

Were Blue Arrow prices the best DMC could find?

255. Mr Cook said at a meeting with HMRC on 17 October 2016 that the prices offered by Blue Arrow were the best that DMC could find; he also said at the same meeting that the prices were not unusual. Mr Kelly in oral evidence did not agree that they were the best prices DMC could find but did consider them good prices and "in the ballpark".

256. This did not strike us as a material inconsistency in the DMC witnesses' evidence, nor as evidence that the prices for the Blue Arrow Goods were uncommercial.

257. We find, based on the DMC witnesses' evidence, that the prices paid for the Blue Arrow Goods by DMC were attractive to it, enabling it to make a commercial margin upon on-sale, but not out of the ordinary. (We make further findings below on DMC's margin on the Purchases and on-sales of the Goods overall).

Findings related to DMC's on-sales of the Goods

Why the large part of the Goods was sold to non-UK customers; why "trade/export" sales increased by 67% over three years

258. HMRC argued that the DMC witnesses, and Mr Talati in particular, "could not explain" why the large part of the Goods was sold to non-UK customers; nor why sales in the "trade/export" part of the business (and so sold chiefly to non-UK customers) increased by 67% (from £9.5 million to £15.9 million) from the year ended 31 March 2014 to the year ended 31 March 2017. In a similar vein, HMRC suggested that it was significant that DMC put forward no evidence that the Goods sold to non-UK customer had first been offered to UK customers.

259. DMC's "explanation" for the preponderance of on-sales of the Goods to customers outside the UK was simply that these were the customers that were found, in the ordinary course of business, to buy the Goods, and given that

(1) a very substantial part of the Distribution business involved selling to non-UK customers – 61% of sales were "export/trade" in the year ended 31 March 2014 (a "neutral" year in the sense that that none of the Purchases and on-sales took place in it);

(2) Mr Talati's focus was on the "trade/export" side of the Distribution business, and he managed most of the Purchases and on-sales; and

(3) some of the Pricemo and Blue Arrow Goods were indeed taken into "stock" and sold to UK customers,

there was nothing uncommercial in the fact that most of the customers found were outside the UK. The DMC witnesses gave oral evidence that DMC did consider a number of UK customers for the Vision Goods, but that Item was chosen on ordinary business grounds such as price and customer relationship. In effect, DMC's answer to HMRC was that preponderant on-sales to non-UK customers did not need "explanation" – it was commonplace in its Distribution business.

260. DMC's response to the phenomenon of 67% growth of the "trade/export" part of the Distribution business was essentially the same: sales growth in itself was certainly not "uncommercial"; it was true that, in these years, the growth came from the "trade/export" part of the business rather than the "UK" part (which stayed broadly steady at around £6 million in sales per annum); however, that reflected nothing more than where the growth opportunities were to be found (and was consistent with the focus of Mr Talati, the business' "star trader", on the "trade/export" side of the business).

261. During cross examination, Mr Talati added a further explanation for the on-sale of most of the Goods to non-UK customers, being that selling goods outside the UK helped to keep competitive prices hidden from official distributors in the UK. HMRC pointed out that this explanation was difficult to reconcile with the fact that DMC had sold goods bought at competitive prices to UK customers.

262. What we draw from Mr Talati's statement during cross-examination is that there were instances where selling goods outside the UK may have achieved the objective he described (which was broadly consistent with evidence, referred to earlier, of the tension between the "official" and secondary markets, and the desire of manufacturers and official distributors to distance themselves (or be seen to distance themselves) from involvement in the secondary market). We did not, however, take Mr Talati's "further explanation" proffered in cross-examination (which neither he nor the other DMC witnesses gave in their witness statements) as the main, or most important, "explanation" for why most of the Goods were sold to non-UK customers. As stated above, DMC's general response was that selling to non-UK customers was commonplace in its Distribution business.

263. We find, based on the DMC witnesses' evidence combined with the clear facts that a very significant portion of the Distribution business' sales were "trade/export", and that Mr Talati's particular focus was on this side of the business, that it was not commercially extraordinary that the large part of the Goods was sold to non-UK customers, nor that, over the four years in question, sales of the "trade/export" side of the business grew by 67% (averaging 22% sales growth per year). In this regards we noted that the sales of DMC's Service business grew from £4 million to £10 million in the same period – i.e. more than doubled – in the same period and its "Direct" business' sales doubled from £3.4 million to £6.9 million in 2013-2016. These figures from unrelated business divisions (which had no connection to fraudulent VAT evasion) show that the level of sales growth in the "trade/export" part of the Distribution business proves little for the purposes of this appeal.

Why the Pricemo Goods Purchased in the "second phase" were on-sold to UK customers

264. HMRC argued that the fact that the Pricemo Goods Purchased in the "second phase" (October 2014 – January 2015) were on-sold to UK customers was evidence that the arrangements were uncommercial. They argued this on the basis that it was around this time that HMRC discovered that Pricemo was fraudulently evading VAT, and they suggested that the organisers of the "wider scheme" for which they contended directed that DMC sell the Pricemo Goods to UK customers as this would attract less attention from HMRC.

265. The Pricemo Goods on-sold in this "second phase" were sold for €327,000 in total. DMC's "explanation" for the sale on the "UK" side of the business was simply that this side of the business had a demand for the Goods at that time, and so they were bought into "stock".

266. We are not persuaded of the likelihood of HMRC's theory, on the evidence before us. The theory, on its face, seems to us implausible, as, given that HMRC had gone so far as to deregister Pricemo by the end of October 2014, it was rather late in the day for the "scheme organisers" to try to change arrangements to deflect HMRC's attention. More generally, as we have found above, selling to UK customers was commonplace for the Distribution business (as was selling to non-UK customers), and so little can be inferred from the bare fact that the buyers were in the UK.

267. We find, based on the DMC witnesses' evidence, combined with the facts that (i) a significant portion of the Distribution business' sales were "UK", and (ii) the amount of Goods sold in this phase was relatively modest, that it was not commercially extraordinary that the "second phase" Pricemo Goods were sold only to UK customers.

DMC Distribution business' approach to commercial risk on customers

268. The DMC witnesses' evidence was that the Distribution business dealt with commercial risk on its customers – essentially, the risk that DMC would not be paid for its goods – by obtaining credit insurance from a third party insurer, Euler Hermes. This was supported by statements to the same effect in the strategic report in DMC's accounts – as well as by Mr Talati's bonus terms, which penalised him if debts were not insured by Euler Hermes.

269. The DMC witnesses said that DMC had the discretion to extend up to £10,000 of credit to a customer without seeking approval from Euler Hermes, though DMC would need to obtain a Creditsafe report that showed the customer was considered creditworthy for least £10,000. Beyond that figure, Euler Hermes consent needed to be obtained. DMC produced documents showing Euler Hermes approvals for the companies to which the Vision Goods were on-sold.

270. HMRC pointed to the following discrepancies in the documentary evidence:

(1) DMC's "Credit Application Form" for Item was signed in April 2016, whereas the sales of Vision Goods to Item had started nearly a year before;

(2) It appears from the Euler Hermes approved limit request reply dated 9 February 2017 (approving a £50,000 limit) in relation to Printberry that the approved limit prior to that decision was nil – and the sale of the Vision Goods to Printberry occurred before that date.

271. We also had in the evidence documents gathered by DMC in relation to a customer that was unconnected with the on-sale of Goods (by the name of Clarity Distribution Ltd), and consisted of the following:

(1) a DMC "Credit Account Application Form" completed by the customer on 5 November 2014 (two trade referees provided);

(2) a Creditsafe report on the customer dated 19 May 2015;

(3) a Euler Hermes credit limit for the customer approval dated 7 April 2016 (£20,000); and

(4) abbreviated accounts of the customer for the year ended 31 March 2014.

272. We find, based on the DMC witnesses' evidence and corroborated by statements in the contemporaneous accounts and the terms of Mr Talati's bonus, that DMC's principal means of dealing with commercial risk on its customers was to obtain credit insurance from Euler Hermes. DMC's "Credit Account Application Form" was relatively unimportant from a commercial point of view. We find, on the same basis, that this approach was generally followed as regards the on-sales of Goods. However, we also find that DMC's processes in obtaining the Euler Hermes confirmation of cover were not flawless – in the cases of both Printberry and the unrelated example, Clarity Distribution Ltd, a year or more passed between the initial documents obtained and getting the documentary confirmation of a credit limit from Euler Hermes. This may have been in reliance on cover up to £10,000 based on the Creditsafe report obtained at an earlier stage (in both cases). We find on the balance of probabilities, and taking into account that

(1) the credit limit document from Euler Hermes for Item, the much larger customer in the Vision Goods on-sales than Printberry, covered the relevant time period, and

(2) the flaw in the Printberry documentation was shared in the documentation for an unrelated case, Clarity Distribution Ltd,

that the flaw in the Printberry documentation can be ascribed to imperfect internal processes (and so is not indicative of an uncommercial transaction)

Findings related to DMC's margin on the Purchases and on-sales

Did DMC negotiate prices with counterparties?

273. Due to DMC's email deletion policy, it produced no documentary evidence to corroborate its witnesses' oral evidence that negotiation of the Purchases and on-sales was conducted as one would expect of unconnected traders in the market. HMRC, however, as part of their enquiries were able to obtain, from an information exchange with the Austrian tax authorities, a chain of emails between Mr Talati and Harald Haider at Item, between October 2015 and March 2016. Because they are quite short but, in our view, revealing, we have reproduced them at Appendix 2.

274. The emails supplement the DMC's witnesses' evidence that DMC, having spoken to a number of potential customers for the Goods offered by Vision and settling on Item, agreed "framework" prices with Vision and with Item (separately), on a footing such that DMC made a margin that was acceptable to it; however, being a "framework" arrangement, none of the parties was bound to buy, or to sell, until standalone orders were agreed in batches over time. Thereafter, Item gave DMC monthly forecasts of what goods it wanted and when. The DMC witnesses' evidence was that this was typically how business was done in the printer consumables market: it meant that there were no detailed written contractual terms other than what was on the invoices (as the parties were not contractually obliged to buy or sell until a given batch of goods was ordered); it meant that "framework" arrangements could be (and

often were) terminated on short notice due to changes in the market outside the parties' control (such as changes in the pricing of the goods in the "official" channels).

275. HMRC argued that the Talati-Haider emails show the customer telling DMC what the price should be – and so support HMRC's contention that an outside party (the organisers of the wider scheme to defraud the revenue) was dictating the price of the on-sale from DMC to Item.

276. We do not read the emails this way, on the balance of probabilities. Their tone and content is in our view what one would expect of negotiation between two seasoned traders in the market: allowing for the banter (and the fact that Mr Haider was not a native English speaker), both sides are seeking to appear reasonable and constructive, whilst testing the other for how far they might bend. It is notable that deferral of payment is a key negotiating "ask" from Item in the first negotiation (October/November 2015) – and Item agrees to DMC's "offer" on the basis of a deferral of payment (see 6 November 2015 email). In the second negotiation (February/March 2016), it is DMC that appears to compromise and accept the price Item was offering.

277. We find that these emails corroborate the DMC witnesses' evidence that DMC's negotiation with Item was done in the manner one would expect between unrelated businesses. We also infer from this, based on the consistency of the DMC witnesses' evidence, which we found credible on this point, that DMC negotiated all the Purchases and on-sales of Goods, as it did any other transaction of its Distribution business. We make this finding cognisant of Blue Arrow's margin of (only) 1% on its purchases (from Bryanswood) and on-sales (to DMC) – however, we do not view this as material to the question of whether DMC negotiated (with Blue Arrow and with other counterparties) in an ordinary commercial manner, as the evidence does not suggest that DMC knew anything about the price at which Vision was buying Goods from its supplier.

278. We have declined to make adverse inferences from the fact that DMC did not call as a witness someone like Mr Haider who worked for a customer involved in the on-sales of Goods, as

(1) we did not consider that a prima facie case had been made for the non-commerciality of the on-sales of Goods: in particular, the fact that the greater part of the on-sales was made to non-UK EU customers was, as we have found, a commonplace of DMCs Distribution business; Item, by far the biggest customer in the on-sales, was an established business in its own right and a large pre-existing customer of DMC; and the 2015-2016 Talati-Haider emails, as contemporaneous documentary evidence, indicated ordinary commercial negotiation; and

(2) even if we had been persuaded that a prima facie case had been made, the case law suggests that, in deciding what inference to draw, we would need to take into account not only the fact that Mr Haider was not called as a witness, but also other matters such as what we consider to be the most probable finding to make on the basis of all the evidence. For the reasons given immediately above, it seems to us that the evidence in its entirety outweighs the "negativity" of any inference which could otherwise be drawn from Mr Haider not being called.

Was the margin on the Purchases and on-sales unusually large?

279. The margin on the Vision Purchases and on-sales was 5%. DMC was not able to say with certainty what the margin on the other Purchases and on-sales was, but it estimated 4-

6%. HMRC pointed to the fact that in a short telephone conversation with HMRC in October 2012, Mr Hill said that the business made 3% margin on office equipment sales to the EU – the suggestion being that DMC made an unusually large margin as a result of its role as "broker" in the wider scheme of the kind for which HMRC contended.

280. When we look at the figures for the Distribution business' sales and gross profit, its typical "margin", in the sense of the proportion of gross profit to sales, was closer to 10% than 5%. Taking, for example, the year ended 31 March 2014 – a "neutral" year because none of the Purchases took place in it – in that year the Distribution business had sales of £15.6 million and gross profit of £1.6 million, making the proportion of the latter to the former about 10%.

281. We therefore find that the margin on the Purchases and on-sales was not unusually large for the Distribution business at the time. Consistent with this, and our findings above as to the prices of the Blue Arrow Goods and the arm's length nature of DMC's negotiations with its counterparties, we also find that the prices at which the Goods were purchased were not out of the ordinary.

Findings related to DMC's awareness of VAT fraud

282. The DMC witnesses said they were aware of the existence of VAT fraud but did not think it was a problem in their industry; they had heard of "carousel" fraud but had only a hazy understanding of it (and, again, did not associate it with anything done in the printer consumables market); they had not heard of "MTIC fraud" until HMRC brought it to their attention in the summer of 2016.

283. HMRC argued that DMC must have been aware that VAT fraud was a problem in their industry, as that must be why one of their actions with regard to new suppliers was to ask to see a VAT certificate and/or run a VAT validation check on the HMRC system. The DMC witnesses responded that these steps were taken chiefly as a means of verifying the supplier's identity.

284. HMRC also submitted that DMC must have realised that the questions HMRC officials asked Mr Cook in December 2012 and February 2014 - as to whether transactions with Magnum Logistics, Zvonim and Praxis SA had taken place - related to suspected VAT fraud by those companies. HMRC submitted that, as a result of these interactions with HMRC officials, DMC was well aware of the risk of VAT fraud at the time of the Purchases and was specifically aware of MTIC fraud from at least the time of HMRC's questions about Praxis SA in February 2014.

285. In addition, there was disputed evidence concerning whether Mr Cook had said at the meeting with HMRC on 5 July 2016 that he knew all about MTIC fraud:

(1) HMRC's report of the 5 July 2016 meeting said:

> "We discussed MTIC fraud risks and related tax losses to the UK public revenue/Other EU Member States. Mr Cook informed as (sic) that MTIC fraud risks were discussed when the business was last visited concerning their 02/16 VAT repayment claim of £198k."

(2) HMRC's report of their meeting with DMC some weeks later, on 16 August 2016, said:

> "Mr Cook was reminded that during our VAT visit that took place on 05/07/2016, when we attempted to discuss MTIC fraud risk awareness he informed us that he knew all about this type of fraud and that it was covered by HMRC Officers when the business was last visited to verify their 02/16 VAT repayment claim. Mr Cook denied all knowledge of MTIC fraud and

stated that the first he had heard of this type of fraud was when we had mentioned it during our visit on 05/07/2016."

(3) In their oral evidence at the hearing, apart from both parties acknowledging that there had been no HMRC "visit" concerning DMC's 02/16 VAT repayment claim (the claim had simply been processed in the usual way), Ms Agyekum-Saki and Mr Cook reiterated their positions as recorded in the 16 August 2016 meeting note: she said that he said what was recorded there about familiarity with MTIC, and he said he had not.

(4) This seems to us an instance of garbled oral communication at the 5 July 2016 meeting (a 2½ hour meeting of which this exchange was a relatively minor part). We do not think either party was deliberately misrepresenting to us what Mr Cook said at that meeting; however, given the oddity of the statement attributed to Mr Cook – as there had been no "visit" to verify DMC's 02/16 claim – and the fact that Mr Cook "corrected the record" at the first opportunity (at the same 16 August 2016 meeting in which HMRC told him of their recollection of the 5 July 2016 meeting), we think it more likely that Ms Agyekum-Saki misheard or misunderstood what Mr Cook was saying at that point in the meeting; and hence we find, on the balance of probabilities, that Mr Cook did not tell HMRC at the 5 July 2016 meeting that he knew all about MTIC fraud.

286. In summary, we accept the DMC witnesses' account of what they were aware of in the realms of VAT fraud, noting in particular that Mr Hastings' evidence supports our finding that MTIC fraud was not known in the printer consumables market at the relevant time; the evidence of intermittent contact from HMRC to ask about three particular companies and transactions supports, in our view, our finding that DMC had a general awareness of VAT fraud, but no sense that it was a material problem in their industry; and we do not think it fairly can be inferred from the fact that DMC checked new suppliers' VAT registration, that it therefore knew that VAT fraud was a problem in the market in which it was operating.

Findings as to the relationship between the Talati brothers

287. Mr Talati's evidence was that that he had a poor relationship with his brother and, despite both brothers being traders in the same market, they did not do business together, due to their estrangement. HMRC argued that this evidence was at odds with certain connections between Zubair Talati and DMC:

(1) Zubair Talati worked at Lampton during the time that Lampton supplied goods to DMC (November 2014 to March 2015); and Lampton started to sell to DMC about 18 months after the end of the year in which the Distribution business' turnover took a marked dip (the year ended February 2013) - HMRC argued that Zubair Talati intended Lampton's supplies to DMC to be of financial benefit to his brother, whose bonus was linked to the business' gross profit.

(2) Sometime prior to February 2013, Zubair Talati proposed sales by Zvonim and Iteks to two UK buyers who went "missing"; DMC bought goods from Zvonim and Iteks in 2009-2011; and Mr Talati was named as the reference on DMC's internal ledger for Iteks.

(3) Zubair Talati received several payments, totalling £7,500, from Ebit Distribution Ltd in late 2010; Ebit Distribution Ltd traded with DMC and for that reason HMRC informed DMC of Ebit Distribution Ltd's VAT deregistration in early 2011.

Mr Talati’s response was that his contact at Lampton was Zulfi Khan (and not his brother); and that his involvement in the purchases from Zvonim and Iteks was marginal.

288. We find on the balance of probabilities that Mr Talati and his brother were estranged and did not cooperate in business matters. We make this finding on the basis of Mr Talati’s evidence, which we found credible in this respect; we are not persuaded, on the evidence, of the likelihood of Zubair Talati somehow engineering sales by Lampton to DMC to benefit his brother – the evidence is in our view too threadbare to make this inference, on the balance of probabilities; and the evidence about Zvonim, Iteks and Ebit Distribution Ltd is, in our view, weaker still as a basis for proving the likelihood of business cooperation between the brothers.

DISCUSSION

Actual knowledge

289. We begin by considering HMRC’s core argument: that there was a scheme to defraud the revenue of wider compass than just the (agreed) fraudulent VAT evasion by Pricemo, Blue Arrow and Bryanswood/Vision, and with certain key features (summarised at [151] above); and that the Tribunal should infer from the existence of such wider scheme, that DMC knew of the Purchases’ connection with fraudulent VAT evasion.

290. Having made further findings of fact, we can now go through the facts which HMRC asserted as supporting findings of non-commerciality (which would in turn support the existence of the wider scheme for which HMRC contended), and record our views:

(1) The **number and amounts of Purchases**: we agree that from the perspective of Pricemo, Blue Arrow, and Vision, “start up” businesses in the printer consumables market and with weak balance sheets, 800 Purchases totalling over £13 million over four financial years (those ending February 2013 and March 2015-2017) is commercially somewhat surprising; from DMC’s perspective, however, such numbers are not: its Distribution business had sales of over £15 million in the single year ended March 2014 (a year in which none of the Purchases took place).

(2) The **consistency of the transaction chains, especially as regards the Vision Goods**: we agree that the fact that Vision had only one supplier, Bryanswood, is commercially somewhat surprising. On the other hand, the fact that DMC sold 90% of the Vision Goods to one customer, Item, does not strike us as commercially odd given that (i) Item was DMC’s biggest customer in 2013-2018, but accounted for (only) 6% of the sales to DMC’s ten largest customers in that period – this was not a case of DMC putting all (or most) of its eggs in one basket; (ii) the business model of the “export/trade” part of the Distribution business favoured the making of “deals” by matching goods purchased and goods to be sold – it therefore made business sense for DMC to sell consistently to one customer which had demand for the Goods; and (iii) DMC had a record of doing business with Item, going back to 2010 – it sold £13.4 million of goods to it in 2010-2016, of which the on-sales of Vision Goods comprise just under £9 million – so it was a £4 million-plus customer of DMC’s, even without the on-sales of Vision Goods.

(3) The **speed with which the Purchases and on-sales were made**: the co-ordination of the Purchases and on-sales was a feature of the business model of the “trade/export” part of the Distribution business: it protected DMC from the risk that it would not be able to on-sell goods at profit (and/or it would incur the expense of holding them in stock for extended periods of time). Indeed, in our view, this agility in

co-ordination was a key element that DMC "brought to the table" in its Distribution business, and thus, economically, helps explain its margins on transactions (including the transactions in question). Indeed, the importance to the "economics" of the business of minimising the holding-period in stock can be seen in the terms of Mr Talati's bonus. We do not therefore agree, on the balance of probabilities, with HMRC's contention that DMC's ability to co-ordinate purchases and on-sales at speed was an indication of non-commerciality or contrived trading.

(4) **Suppliers paid early, and in excess of credit limits**: we have found that it was commercial for DMC to agree, as part of a package of terms that included price, to early-pay upon satisfactory checking of goods, especially as regards smaller counterparties in weaker cash positions: this practice did not compromise DMC's basic approach to commercial risk as regards suppliers (as we have found it), and allowed DMC to "exploit" its strong solvency position in exchange for other commercial benefits (such as price). We do not therefore find, on the evidence and on the balance of probabilities, that such early-payment was circumvention of DMC's ordinary commercial practices. As to why the suppliers gave DMC credit in excess of the figure on DMC's "Approved Supplier" form (the example of this on the evidence is Vision, whose form showed a 300,000 limit): we agree with HMRC that this is commercially odd from the perspective of Vision (although it may have been a quid pro quo for DMC agreeing to early-pay, following checking of the Goods).

(5) No written terms and conditions from suppliers (apart from "retention of title" wording on invoices): from DMC's perspective, an absence of written terms and conditions imposed by the supplier (such as happened when DMC signed supply agreements with the large manufacturers directly) was a commercial advantage – indeed, by signing DMC's "Approved Supplier" form, suppliers such as those involved in the Purchases were agreeing to *DMC's* terms and conditions. We have found that DMC's agreement to early-pay smaller suppliers was consistent with a "light" approach to terms and conditions: it did not compromise DMC's basic approach to commercial risk on suppliers (being to check goods rigorously and not pay until satisfied with the goods); from the supplier's point of view, early-payment by the customer mitigated the risks posed by "light" documentation.

(6) **Suppliers' source of Goods unknown**: we have found that DMC commonly did not know suppliers' source of the goods it was buying: this was therefore not a distinctive feature of the Purchases.

(7) **End-user of Goods unknown**: the fact that DMC had no information about the end-users, or retailers, that acquired the Goods after they were on-sold to DMC's customers, does not strike us as commercially strange – it was a matter for DMC's customer, as to what it did with the Goods. Indeed, it would seem to us commercially odd if DMC had been told to whom its customers planned to sell the Goods.

(8) The **length of the transaction chains**: HMRC's point here (the irrationality of having so many intermediaries in a supply chain) seems to us in large part a theoretical critique of the secondary market in printer consumables as a whole, as we have found it. Once goods entered the secondary market, it seems to us that what traders "brought to the game" was their contacts, experience, and quick-wittedness. In addition, the considerable difference between manufacturing cost of printer consumables, and their cost to the end-user, allowed for a number of intermediaries each to garner some profit

along the supply chain. Putting economic theory (on which we profess no special expertise) to one side, the key point for us was whether, on the evidence before us and the balance of probabilities, the Purchases and on-sales of Goods were typical activity in the secondary market. We found that they were.

(9) **Consistency of the prices at which the Goods were Purchased and on-sold**: general consistency of pricing (as opposed to rigid uniformity, which was not the case here) does not seem to us an indication of non-commerciality: we have found that the prices were not out of the ordinary and that the parties negotiated 'framework' agreements under which prices were agreed, but with no binding obligation to buy or sell.

(10) **Amount of DMC's profit on the Purchases and on-sales**: we have found that a 5% mark up, which was DMC's average mark-up on the Vision Goods, was not unusually large for the Distribution business at the time. As to whether this was (in HMRC's words) "money for nothing", this seems, again, a theoretical critique of the market as a whole – to which we find the answer, on the balance of probabilities, is that what traders "brought to the game" was their contacts, experience, and quick-wittedness. DMC's 5% profit was therefore no indication that it was taking risk as the "broker" in MTIC fraud.

(11) **Paucity of documentary evidence of negotiation** between DMC and its counterparties in the Purchases and on-sales: we have found that DMC's negotiation with its counterparties was done in the manner one would expect between unrelated businesses. As we noted in making that finding, Vision's 1% mark-up is an indicator of non-commercial negotiation on *Vision's* part; but it is not, in our view, an indicator of non- commercial negotiation on *DMC's* part.

(12) **"Best" prices**: we have found that the prices paid for the Blue Arrow Goods by DMC were attractive to it, enabling it to make a commercial margin upon on-sale, but not out of the ordinary.

(13) **The fact that the large part of the Goods was on-sold to EU customers and 67% growth of "trade/export" side of the business over four years:** we have found that it was not commercially extraordinary that the large part of the Goods was sold to non-UK customers, nor that, over the four years in question (the year ended 31 March 2014 to the year ended 31 March 2017), sales of the "trade/export" side of DMC's Distribution business grew by 67% (averaging 22% sales growth per year)

(14) **Suppliers unknown**: we have found that the presence of small and/or new businesses in the secondary printer consumables market was commonplace, for commercial reasons.

(15) **Blue Arrow's poor delivery record**: we have found that steps were taken to deal with the problems; and, following this, the deliveries returned to a satisfactory standard - and so we find that this improvement in performance was, in essence, why DMC continued to buy from Pricemo and Blue Arrow, despite the earlier problems.

(16) **DD procedures**: we have found that DMC's basic approach to commercial risk on suppliers was to have procedures for rigorous checking of goods, and pay the supplier only once satisfied the goods delivered met DMC's expectations. In addition, it took certain supplemental actions when dealing with new suppliers, involving the gathering of documents – but, provided the legal existence of the supplier entity was

verified, the information contained in these documents was accorded minor importance where there was a pre-existing business relationship with someone at the new supplier. We would not describe DMC as having, as Mr Cook did in his email to Mr Talati of 21 May 2015, "robust procedures in place for assessing the suitability of new suppliers"; however, DMC did in our view have a robust procedures overall for dealing with commercial risk on suppliers.

We have found that this approach explains why the Purchases went ahead, despite the discrepancies in the suppliers' documents, their directors' lack of experience, and the outcomes of online credit checks, as highlighted in HMRC's arguments. The documents and online credit checks gathered by DMC on the suppliers were afforded relatively little attention, given DMC's pre-existing business relationship with Zulfi Khan of Vision (based on €1.4 million of purchases over four months, when he was at Lampton) and Hafeez Rehman of Blue Arrow (based on dealings with him at Pricemo).

As for customers, we have found that DMC's approach to credit risk on customers was to obtain credit insurance from Euler Hermes; and that this approach was generally followed in respect of the on-sales of Goods, albeit that the process was not flawless.

We therefore do not agree that DMC carried out substantially less checks on the suppliers from which it purchased the Goods, and on the customers to which it on-sold the Goods, than it did on other suppliers and customers.

291. We now consider the findings of non-commerciality which HMRC invited us to make:

(1) The evidence does not in our view support our finding, on the balance of probabilities, that DMC was told by a third party who to buy the Goods from, who to sell them to, and at what price. The buyer of most of the Goods was Item, a large and established company with which DMC had done millions of pounds of business since 2010, years before the first Vision or Blue Arrow Purchase – the evidence does not suggest that DMC had to be "told" to do business with Item. Generally, the prices of the Goods were not out of the ordinary and DMC's mark-ups were not excessive – the evidence does not indicate the likelihood of a third party "telling" DMC at what price to buy and sell.

(2) The evidence does not in our view support our finding, on the balance of probabilities, that the Purchases and on-sales took place in an artificial market in the Goods engineered by the scheme organisers. Rather, they bear the hallmarks of ordinary trading in the secondary market for printer consumables. HMRC argued that the "genuine" market in the Goods was limited to £6 million per year, as this was the amount of the Distribution business' "UK" sales during the years in question. We do not agree. The secondary market, as we have found it, was a global market, where profit was made arbitraging price differentials between countries and regions. This was the market for the Goods purchased by DMC. There was not in our view persuasive evidence to suggest that the Goods were in excess of the needs of that global market, and so indicating that the transactions were carried out in an artificial market. The fact that DMC – just one company operating in this market – alone made £9.5 million of "trade/export" sales in a single year (that ended March 2014, a year in which none of the Purchases took place) indicates that the "genuine" market was large enough to absorb the £14.6 million Goods acquired over four financial years.

(3) The evidence does not in our view support our finding, on the balance of probabilities, that the pricing of the Purchases and on-sales did not reflect commercial factors but rather reflected the roles of the parties in the wider scheme to defraud the revenue, for reasons we have already explained.

292. We agree with HMRC that the phenomenon of entities being "replaced" (Pricemo by Blue Arrow, Lampton by Vision) is consistent with those entities being part of a scheme to defraud the revenue, as is the trading (on seemingly uncommercial terms, given Vision's mark-up of only 1%) between Vision and Bryanswood, which suggests that Vision was inserted into the supply chain as a "buffer" (to use 'MTIC' jargon) to make it somewhat more difficult to identify the fraudulent VAT evasion being carried out by Bryanswood. These features do not, however, in our view, support the key features of the "wider" scheme for which HMRC contend: whilst they confirm that the suppliers in the Purchases were involved with fraudulent VAT evasion, they do not indicate, for example, DMC buying and selling the Goods as part of an "artificial" market, or being told by the scheme organisers who to buy from and sell to. Furthermore, we find that those features were not known to DMC at the relevant times: DMC was given a commercial reason for the switch from Pricemo to Blue Arrow (see [54] above) – we find that this was plausible at the time, given that DMC checked the website showing 'Pricemo' operating in Pakistan; and DMC was not aware that Vision was being supplied by Bryanswood (or of the relationship between them).

293. As for a linkage, as HMRC submitted, between Pricemo/Blue Arrow on the one hand, and Vision on the other – for which the main evidence appeared to be Vision's payments of £16,000 to a Mr Mayet, who had indirect connections with Pricemo and Blue Arrow, in 2015-2016 – we are not persuaded, on the evidence, that there was a single scheme to defraud the revenue encompassing all the Purchases in this way. It does not, in any case, appear to us to be a significant issue in the argument in this case: even if there was one scheme to defraud the revenue that encompassed all the Purchases, this does not tell us whether the scheme had the key features contended for by HMRC, such as the Goods having been bought and sold in an "artificial" market, and DMC being told by the scheme organisers who to buy from and sell to.

294. We shall now consider what we have called, in our summary of their arguments, HMRC's "additional" arguments as to why DMC *knew* the Purchases were connected with fraudulent VAT evasion:

(1) HMRC framed a set of arguments around the question of why those fraudulently evading VAT (i.e. Pricemo, Blue Arrow and Vision/Bryanswood) "chose" to sell Goods to DMC. HMRC argued for two alternative answers to their question, on which we now give our views:

(a) HMRC's first "answer" was that these companies wanted to deal with DMC because they had told DMC of their fraudulent VAT evasion: HMRC argued that they *must have* told DMC as, otherwise, an experienced market player like DMC would have found them out and reported them to HMRC.

We have found that DMC's basic approach to commercial risk on suppliers focused on the supplier's ability to "deliver the goods" – an approach which, frankly, had no regard to whether the supplier was engaged in fraudulent VAT evasion. The supplemental actions taken by DMC, as regards new suppliers, as we have found them, were not intended, nor were they effective, to find out whether the supplier was engaged in fraudulent VAT evasion. They had the much

more modest aim of verifying the entity's existence. In these circumstances, we cannot accept HMRC's argument that DMC "must have known" because, otherwise, it would have discovered the fraudulent VAT evasion.

As for DMC's being experienced in the market and so "nobody's fool" – the term used by HMRC's counsel in submissions and cross examination – we find that DMC was, indeed, well able to protect its commercial interests in its dealings with suppliers – as evidenced by its approach to commercial risk on suppliers, which was an effective one. DMC was also effective in generating profits – the terms of Mr Talati's bonus clearly incentivise the "star trader" to maximise gross profit. Where, in our view, DMC's was, frankly, "unsophisticated", was in its procedures to discover whether a suppler was engaged in fraudulent VAT evasion (or indeed any other organised crime). DMC effectively had no such procedures.

(b) HMRC's alternative answer to their question was that these companies wanted to deal with DMC because DMC was not "choosy" about its suppliers. We agree with this sentiment, with the proviso that suppliers had to prove themselves able to "deliver the goods". However, this is in no sense a complete answer to the question of why Pricemo, Blue Arrow and Vision approached DMC with a view to sales. The reasons given by DMC's witnesses - DMC's market reach and reputation, its size and financial stable position – were critically important.

(c) By asking why those fraudulently evading VAT "chose" DMC, HMRC were, it seems to us, trying to highlight features that *distinguished* DMC from other potential buyers of goods in the market. We must therefore address the question: did DMC's lack of effective procedures to discover to whether suppliers were engaged in fraudulent VAT evasion, mark it out from other potential buyers of goods in the market? We find, based on DMC witnesses' evidence, corroborated by that of Mr Hastings, that organised VAT fraud, like MTIC fraud, was not a known problem in the secondary market in printer consumables. An inference may fairly be made that DMC's lack of procedures to discover whether a suppler was engaged in fraudulent VAT evasion did not mark it out from other potential buyers of goods in the market. We find it is more likely that what distinguished DMC in the eyes of Price, Blue Arrow, and Vision as a potential buyer of the Goods was, as the DMC witnesses said, its market reach and reputation, its size and financial stable position.

(2) Another strand of HMRC's argument presented Mr Talati as a "bad apple" within DMC as regards knowledge of the Purchases' connection with fraudulent VAT evasion:

(a) HMRC argued that Mr Talati, as the individual at DMC who managed most of the Purchases, knew of the connection with fraudulent VAT evasion and took advantage of DMC's lax "due diligence" and payment procedures, and of the fact that his judgement was highly trusted by his superiors, to ensure that others at DMC did not find out. Mr Talati had a motive, under this argument – his commission depended on gross profit generated, and, on HMRC's calculations, which appear reasonable, just over a third of his commission for the three years ended March 2015-2017 derived from Purchases and on-sales of Goods. HMRC presented (i) Mr Talati's links with his brother, Zubair Talati, who appeared himself to be linked to fraudulent VAT evasion activity, and (ii) the fact that two

companies that were suppliers to Blue Arrow were also DMC customers managed by Mr Talati, as further evidence for the "bad apple" proposition.

(b) As Mr Talati (like the other DMC witnesses) denied knowledge at the relevant times of the Purchases' connection with fraudulent VAT evasion, and as there was no *direct* evidence, documentary or otherwise, that he had such knowledge, the question for us is whether, in all the circumstances, and on the balance of probabilities, he is to be believed.

(c) Our view of the circumstances is that the market in which Mr Talati, and indeed DMC, was operating, was for all practical purposes unaware of, and consequently indifferent to, the risk of fraudulent VAT evasion - and indeed other organised crime, be it money laundering or dealing in stolen goods. (We say, "for all practical purposes", because, although there was awareness at a general level of VAT fraud, and indeed other kinds of organised crime, it was not thought to be a problem found in the printer consumables market). The fact that Mr MacGregor of CE Logistics was engaged in conspiracy to manufacture illegal drugs, around the same time as running a company selling millions of pounds worth of printer consumables to DMC, is, in itself, of little relevance to the issues in this case – but does anecdotally support our impression of a market in which a trader's ability to "produce the goods" was paramount and background checks of little or no importance.

This is the backdrop to the "lax" procedures of which it is said Mr Talati took advantage, and to the untrammelled incentivisation of Mr Talati, through his bonus terms, to generate gross profit. These circumstances do not in our view, on the balance of probabilities, support an inference that those fraudulently evading VAT brought Mr Talati into their confidence and informed him of their fraudulent VAT evasion. There was no need to, in such circumstances; and so, to do so would have been counter-intuitive for those fraudulently evading VAT. Furthermore, the evidence indicated to us that Mr Kelly had a good deal of familiarity with those at Blue Arrow and Vision with whom Mr Talati was dealing on a day to day basis; that, despite working from home when not meeting clients or attending meetings at DMC's head office, Mr Talati had a close and collaborative working relationship with his boss, Mr Kelly; and that Mr Kelly, in turn, had close business relationships with Mr Cook and Mr Hill. We find it unlikely, in such circumstances, that Mr Talati could have operated as a "bad apple", alone privy to information from Hafeez Rehman and Zulfi Khan about their companies' VAT evasion.

(d) As we found have that the Talati brothers were estranged and did not cooperate in business matters, we do not consider the evidence of Zubair Talati's connections with fraudulent VAT evasion to be materially relevant, and so have made no findings of fact based on that evidence.

(e) That some of Blue Arrow's suppliers were also DMC customers managed by Mr Talati, does not, in our view, tilt the balance in favour of viewing Mr Talati as the "bad apple" at DMC.

(3) A further set of HMRC's arguments focused on the figures for sales and gross profit of the Distribution business for the year ended February 2012 and the following five years:

(a) HMRC noted that the Distribution business' sales and gross profit figures dipped fairly sharply in the year ended February 2013, and then gradually recovered over the next three or four years up to around the figures for the first year, that ended February 2012. We understood HMRC to be suggesting that there was a business imperative to return to the levels of sales and gross profit seen in the year ended February 2012 – and that, due to this business pressure, DMC entered into arrangements which it might not otherwise have done (i.e. the Purchases and onward sales of the Goods). In our view, whilst it is clear that DMC wished, generally, to maximise gross profits of the Distribution business (and increasing sales was a means to achieving this), the evidence did not suggest unusual or undue pressure on the business to return specifically to the levels seen in the year ended February 2012. In fact, the directors' report for the year ended February 2013 indicated the opposite: that the performance in the year ended February 2012 was due to particular circumstances which no longer prevailed. We therefore find, on the evidence before us and the balance of probabilities, that the "return" to the figures for the year ended February 2012 was not a specific goal of DMC's management, but rather part and parcel of its ongoing, and ordinary, pursuit of maximum gross profit. Furthermore, the gradualness of the increase in the figures from the trough recorded in the year ended February 2013, indicates an ordinary pattern of growth – the fact that the upward trend started in the same year as the first Purchases (which were relatively small) does not, in our view, support the thesis that the Purchases were an out-of-the-ordinary phenomenon engendered by a desire to return to the highs of the year ended February 2012.

(b) As HMRC rightly pointed out, the levels of sales and turnover achieved by the Distribution business in the years ended March 2015-2017 owed much to the Purchases and on-sales, especially of the Vision Goods; and were led by the "export/trade" part of the business. These transactions clearly were "important" to DMC in the sense that DMC valued the gross profit they generated – as did Mr Talati, whose bonus was tied to those figures – although, relative to DMC as a whole, the contribution to gross profit was very small (around 2%). What we derive from this evidence is a finding that DMC's Distribution business was driven by gross profit – indeed, this is perfectly clear from Mr Talati's bonus terms. It does not, however, indicate to us that there was something out-of-the-ordinary about the Purchases and on-sales of Goods, from DMC's perspective.

Conclusions on actual knowledge

295. HMRC built their case for "actual knowledge" on the existence of a scheme to defraud the revenue with certain features; they argued that if the Tribunal found that such a scheme existed, inferences as to DMC's knowledge of the Purchases' connection with fraudulent VAT evasion could be made.

296. It was common ground that Pricemo/Blue Arrow, and Vision, were each parties to a scheme to defraud the revenue comprising the fraudulent evasion of output tax on the Purchases. The links between Vision and Lampton, and between Lampton and various bogus companies ordered into liquidation in 2016, as set out above in our initial findings of fact, are not surprising when viewed in that light. Those linkages do not, however, in our view, assist in answering the question of whether the schemes to defraud the revenue in which Pricemo/Blue Arrow and Vision were involved, included the critical elements described at

[151] above (the centrality of DMC's VAT credit to the scheme and the artificiality of the market in which the transactions took place).

297. Based on our findings of fact, we have been unable to make the findings of non-commerciality which would support the existence of a scheme to defraud the revenue of the kind for which HMRC contend. In particular, it was not in our view proven that

(1) DMC was told by the organisers of the scheme who to buy from, who to sell to, and at what price;

(2) DMC's Purchases and on-sales of the Goods took place in an artificial or contrived market; or

(3) The VAT credit obtained by DMC on sale of the Goods to customers outside the UK was a critical element in the scheme from the point of view of the scheme organisers.

298. We have not therefore been persuaded that the Purchases were part of an arrangement that answers to the description of 'MTIC fraud' found in the extracts from First-tier Tribunal decisions contained in Appendix 1. Rather, they are part of an arrangement that answers to the description of 'acquisition fraud' found in those extracts.

299. It follows that we are unable to make the inferences as to DMC's knowledge of the Purchases' connection with fraudulent VAT evasion which HMRC invited us to make, based on the existence of a scheme to defraud the revenue of the kind for which they contended.

300. Having rejected HMRC's arguments on this point, we nevertheless still pose for ourselves the question of whether we can infer from all the circumstances, as we have found them, that DMC knew of the Purchases' connection with fraudulent VAT evasion. It will be clear from our findings of fact, and our review of the facts that HMRC argued supported making findings of non-commerciality, that we consider the Purchases and on-sales of Goods as bearing the hallmarks of ordinary commercial activity from DMC's perspective. This is plainly so in respect of the on-sales of Goods; as regards the Purchases, it is so because of manner in which DMC ordinarily did business – such as, critically, its basic approach to commercial risk on suppliers. In such circumstances, we are unable to infer knowledge of the Purchases' connection to fraudulent VAT evasion on DMC's part – or indeed of the other "behind the scenes" information about Pricemo, Blue Arrow and Vision/Bryanswood enumerated at [205] above. It will be noted that, as part of considering HMRC's "additional" arguments, we specifically considered making inferences as to Mr Talati's knowledge, and decided that the circumstances did not support our making an inference that he knew of the Purchases' connection with fraudulent VAT evasion. In essence, the reasoning we applied to the circumstances of Mr Talati apply all the more strongly to the other individuals whose knowledge could be attributed to DMC – Mr Kelly, Mr Cook and Mr Hill. We say "all the more strongly" only because some or all of the circumstances arousing suspicion in relation to Mr Talati – such as his relationship with his brother, and his bonus arrangements – do not apply to these other individuals.

301. We accordingly conclude that DMC did not know that the Purchases were connected with the fraudulent evasion of VAT.

"Should have known"

302. We considered whether a reasonable businessperson with ordinary competence, faced with the facts as we have found them, would have known what DMC did not - that the Purchases were connected with fraudulent VAT evasion. Would such a businessperson have

concluded that DMC ought to have known that the only reasonable explanation for the Purchases was that they were connected with fraudulent VAT evasion?

303. Most aspects of the circumstances would not, in our view, have indicated such a connection, in the eyes of such a businessperson:

(1) The Goods bought and sold were the "stock in trade" of DMC's Distribution business, an established division of a medium sized company, itself turning over millions of pounds a year; the Distribution business was built on trading products like the Goods, and had a warehouse team who were adept at quality-checking goods coming in. The facts indicate that the Goods very largely met the standards DMC expected – and, in the exceptional cases where they did not (some of the Pricemo and Blue Arrow deliveries), DMC took appropriate action and the problems were sorted out.

(2) The manner of the Purchases and on-sales was typical of the market in which they took place: the secondary market in printer consumables was a forum where printer consumables were traded between businesses that were themselves neither manufacturers nor end-users; cross borders sales in this market were commonplace because an important source of profit was arbitrage between prices in different countries and regions. It was also commonplace to find new and small businesses in the market – like the suppliers in the Purchases.

(3) Selling goods to overseas buyers was the staple of the "trade/export" side of DMC's Distribution business, itself well established and doing millions of pounds of deals each year, ignoring the transactions in question entirely; the individual who managed most of the transactions in question, Mr Talati, was DMC's "star trader" hired to expand the "trade/export" side of the business and incentivised by his bonus arrangements to maximise gross profits.

(4) The fact that the Goods were, on the whole, rapidly on-sold to customers was an ordinary feature of DMC's Distribution business, which had the commercial objectives of minimising the time goods were held in stock and, as much as possible, matching purchases with sales, to lock in gross profit. Some Goods were, however, bought for the "UK" side of the business and so held in stock – this too was an ordinary feature of the Distribution business.

(5) There was no indication that the Goods were ultimately sold "in a circle" back to DMC's suppliers or persons connected with them; DMC did not know the ultimate end-users of the Goods, but that would not have struck the reasonable businessperson as indicating connection with fraudulent VAT evasion.

(6) There was no indication that DMC was approached by a third party with a "package" proposition that included the profit DMC would make on buying and selling the Goods; rather, DMC's role in the Purchases and on-sale of Goods, as it was throughout its Distribution business, was as a "middle man" or "marketing intermediary", putting together unconnected sellers and buyers and profiting from its connections, experience and quick-wittedness in making a deal. Its profit on the transactions in question was not excessive compared to its average mark up on purchases.

304. Some aspects of the circumstances would have raised question marks in the minds of a reasonable businessperson:

(1) The sellers were companies with small net assets; they were not, according to the online credit checks obtained, very creditworthy. The reasonable businessperson may well have wondered how such companies were funding acquisition of batches of hundreds of thousands of pounds worth of Goods. To some extent, the reasonable businessperson's questions would be answered by the fact that DMC agreed to early-payment as a commercial term of the Purchase: this reduced the suppliers' own credit exposure. Beyond this, however, the reasonable businessperson would have noted that there "must be something else going on" to enable such "£1 companies" to supply in the volumes seen in the Purchases. That "something else" may have been as simple and unremarkable as the companies receiving financial support from a connected person, such as an owner/shareholder. At the other end of the spectrum, it could also have been something nefarious, such as involvement with money laundering, stolen goods, or VAT evasion. The reasonable businessperson would note that DMC entered into the Purchases not knowing the answer to the question of how the supplier companies were funded.

(2) Although DMC had established business relationships with Zulfi Khan of Vision (through €1.4 million of sales over four months when he was at Lampton) and Hafeez Rehman of Blue Arrow (through the relationship built up with Pricemo), it knew little about the other company directors of the suppliers, how they had become involved in the printer consumables business, and why there were discrepancies in the description of the supplier companies' business activities in VAT and Companies House records. The reasonable businessperson would have noted that, like the point above, DMC did not have a complete picture of its counterparty. The reasonable businessperson would have noted that, because it placed such heavy reliance on its relationships with individuals it knew and trusted, DMC was taking the risk that others "behind the scenes" could be involved in activities with which DMC would not want to be associated – like money laundering, dealing in stolen goods – or fraudulent VAT evasion. Similar to the point above, DMC had entered into the Purchases without a complete picture of the management of the supplier entities.

(3) The reasonable businessperson would note that both the above points stemmed from DMC's basic approach to commercial risk on suppliers, which was to check rigorously the goods they delivered, and pay only if satisfied with the goods; and its tendency to place much store on business relationships and pay relatively little attention to documentary "due diligence" over and above verifying the entity's legal existence. The reasonable businessperson would equally have understood that this was an adequate approach to protecting DMC's commercial interests; and was DMC's approach across the board, not just for the Purchases. Their concerns would not, therefore, have been on account of DMC acting in an uncommercial manner; rather, it would have been on account of DMC's seeming lack of concern at the risk of being involved or associated with persons who might be up to "no good". The reasonable person would have appreciated the reason for that lack of concern: DMC's belief that organised financial crime was not a problem in the industry in which it was operating.

305. Looking at the circumstances of the Purchases in the round, therefore, the reasonable businessperson would have known that there was a risk that the suppliers were involved in nefarious activity, be it money laundering, dealing in stolen goods, or fraudulent VAT evasion. However, that businessperson would not have concluded that such criminal activity was the only reasonable explanation for the Purchases: most aspects of the Purchases were

entirely unremarkable, and the questionable aspects had reasonable explanations which involved no criminality: for example, that the suppliers were financially supported by their owner/shareholders by means of guarantees or gift of funds when needed; that some of the suppliers' VAT and Companies House records had not been updated to reflect the companies' latest business activity; and that the company directors carried on more than one business activity and/or hired the likes of Hafeez Rehman and Zulfi Khan to carry on day to day activities.

306. Knowing that there was a risk of the Purchases being connected with fraudulent VAT evasion does not satisfy the extent of knowledge required under the case law – there must be knowledge that the Purchases *were* connected with fraudulent VAT evasion. We therefore conclude that a reasonable businessperson would not have known that the Purchases were connected with fraudulent VAT evasion; such a person would not have concluded that DMC ought to have known that the only reasonable explanation for the Purchases was that they were connected with fraudulent VAT evasion.

307. We also considered whether DMC had the means at its disposal of knowing that by the Purchases it was participating in a transaction connected with fraudulent evasion of VAT – and if so, did it fail to deploy those means. For the reasons just given, we find that DMC had the means at its disposal of knowing that there was a risk that it was so participating – but this falls short of the extent of knowledge required under the case law.

CONCLUSION

308. For the reasons set out above, we consider that, although the Purchases were connected with the fraudulent evasion of VAT, DMC neither knew, nor should have known, of that connection; we therefore allow the appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

309. 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.

ZACHARY CITRON
TRIBUNAL JUDGE

RELEASE DATE: 15 MARCH 2021

APPENDIX 1: FTT DECISIONS ON DIFFERENCE BETWEEN 'MTIC FRAUD' AND 'ACQUISIION FRAUD'

EXTRACT FROM *ELECTRICAL ENVIRONMENTAL SERVICES LTD* [2014] UKFTT 0129 (TC)

Judge Mosedale and Mr Sharp

MTIC fraud

2.

Many previous tribunals and higher Courts have given a description of MTIC fraud such as by Burton J in *R (Just Fabulous (UK) Ltd) v HMRC* [2007] EWHC 521 at §§5-7; Floyd J in *Mobilx Ltd (In Administration) v HMRC* [2009] EWHC 133 at §§2-3, and Clarke J in *Red 12 Trading Ltd* [2009] EWHC 2563 (Ch) at §§2-8.

3.

Simple missing trader fraud relies on a VAT free purchase by the fraudster. The fraudster then sells the goods on at a price including VAT but fraudulently fails to account to the tax authority for the VAT. A normal method of acquiring goods VAT free is to purchase them from another EU member state as the VAT rules provide that intra-EU transactions are free of VAT. This gives simple missing trader fraud the name of "acquisition fraud" as VAT legislation refers to cross border intra-EU purchases as acquisitions.

4.

This 'simple' fraud depends on the defaulter having a genuine buyer willing to purchase the goods and pay the price plus VAT. The profit to the defaulter is the VAT which is paid by the genuine buyer but which the defaulter fails to account for (hence the description "defaulter"). It is possible, in order to induce a genuine buyer to buy the goods, that the defaulter enticed the buyer with a price below the market price, possibly a price below the price he paid for the goods: in such a case the "profit" of the fraud will be less than the VAT defaulted on as it will be reduced by the loss on the net sale price.

5.

This 'simple' fraud has a natural limit. It requires the identification of genuine buyers prepared to buy stock, so the need for genuine market demand limits the possible extent of this fraud. As the defaulter is dealing in a genuine market, it is also limited by the likelihood that the genuine buyer would prefer to buy from a trader known to the market, so it will have come-back if something goes wrong. And although pricing below the market price might tempt some buyers, it might also make them suspicious.

Organised missing trader fraud ("MTIC") or carousel fraud

6.

Perhaps out of this simple missing trader fraud, which we shall refer to as acquisition fraud, and not to be confused with it, was born a much more sophisticated fraud. It is referred to as MTIC (for 'missing trade intra-community') fraud or carousel fraud. This fraud dispenses with the genuine market: the defaulter creates an artificial market. Therefore, a genuine market does not limit the extent of the fraud: on the contrary, this fraud can be committed as often as the fraudster desires – at least until suspicions are raised. It is a pernicious fraud as it has no natural limit other than the pockets of the governments of EU member States.

7.

As it relies on an artificial market, how does the fraudster realise his profit? The profit in an acquisition fraud arises by the missing trader running off with the VAT generated by a

genuine sale onto a genuine market. The market in MTIC fraud is artificially generated: the fraudster organises the purchases and sales of the goods so the goods and money are likely to move in a circle of transactions beginning and ending with the fraudster or a person acting on his behalf. So merely running off with the VAT would be pointless as, logically, the money in the chain will have originated with the fraudster (even if it passes through the hands of innocent dupes caught up in the artificial chain).

8.
For this fraud to be profitable, it relies on not only the VAT free acquisition by a trader of the goods *within* the UK but a VAT free sale of the goods *out of the UK*. The VAT free sale by the exporter (the 'broker') to another EU country, which entitles the broker to recover VAT paid to his supplier, is the key to this fraud.
9.
Perhaps the simplest explanation of this fraud is that its object is to induce HMRC to refund to the broker VAT that was never actually paid to HMRC by the broker's (ultimate) supplier.

10.
The person making the cross-border sale is the lynchpin of the fraud, whether or not he knows it. He doesn't have to understand his role. As long as the broker, when selling the goods pays his vendor *more* than he receives from his buyer, the fraudster is able to extract the fraudulent profit.
11.
For the fraud to work the broker has to be induced to pay more than he receives: in other words he has to be induced to put some of his own money into the chain. He may be induced to do this if there is profit in it. The broker's buying price includes VAT but his selling price does not. But if his net buying price is less then his selling price he will make a profit as long as HMRC refund the VAT.

12.
And of course the fraud is lucrative for the fraudster as the fraudster causes the acquirer to default on the VAT on the importation (or 'acquisition') in the UK. So it is essential that there is still a missing trader. But the missing trader is not the lynchpin of this fraud: the object of the fraud is the broker's VAT reclaim.

13.
In this artificial market, the goods are bought and sold but there is no real market for the goods. For this type of fraud it is not even necessary for the goods to actually exist. (We note in passing that there is no allegation in this case that the goods in EES's supply chains did not exist).

14.
The fraud as described does not depend on the broker knowing that his role is vital to a fraud. It is possible that, so far as the broker is aware, he is simply buying and selling goods at a profit. Whether any particular alleged broker is aware of the fraud (if proved) is a question of fact.

15.
As MTIC fraud and acquisition fraud both involve missing traders it is easy to confuse them although they are two very different frauds. An analysis of cases indicates that even the

courts have not always appreciated the difference. For instance, Lewison J in *Livewire* at [96] said 'what is extracted from the public revenue is not the repayment of VAT at the end of the chain, but the VAT for which the defaulter should have accounted but did not.' which is a description of acquisition fraud and not MTIC fraud.

Why sometimes termed 'carousel fraud'

16.

The fraudster is arranging a chain of transactions in which the sale to and by the broker is essential for the fraud to work. The sale to and by the broker is the lynchpin of the fraud, its raison d'etre. So the fraudster has to arrange a sale to the broker and a sale by the broker. Therefore, ultimately a company (or companies) controlled by the fraudster must directly or through buffers sell the goods to the broker, and directly or through buffers buy the goods back from the broker.

17.

As the fraud has no limit, it made sense for the fraudster to re-use the same goods and the same brokers and commit the fraud as often as possible sending the same goods round the same transaction chain. This gave the fraud its name of "carousel" fraud because the goods may go round in circle. But it is often a misnomer. Although the transaction chain (or at least the chain of money as the goods may not exist) must start and end with the fraudster or a company or person controlled by him, it is not necessarily the same person or company at the start and end of each chain. Further, the fraudster is likely to use a large number of buffers and brokers in lots of different chains in order to commit the fraud as often as possible. Therefore, although the same goods may circulate many times, they do not necessarily pass through the hands of the same broker more than once.

Variations on a theme

18.

As we have said the fraud could be very lucrative and theoretically without limit. In practice though there might be a finite limit of brokers with resources to buy at one gross price and sell at a lower gross price, funding the difference from their own resources pending the VAT repayment by HMRC. The fraudster, therefore, might take a hand in this and put the broker in funds. The fraudster might arrange for loans or other funding to be made available to the broker.

Protecting the broker

19.

It will be important to the fraudster (even where the broker is entirely independent of the fraudster) that the broker recovers its input tax (or at least believes that he will) because otherwise the broker will not buy the goods. The fraudster must want to protect the brokers he uses, as a fraud takes effort to organise and it must be easier if the same broker can be used in a transaction chain time and time again.

20.

The first and most common method of protecting the broker's input tax reclaim was to introduce buffers in the chain between the defaulter and the broker so that the broker was not purchasing directly from the defaulter, nor the broker selling directly back to the fraudster. Of course, the buffers themselves may not understand that their transaction was part of a series of transactions organised for the purpose of fraud.

21.
Buffers offered some protection because if HMRC investigated the broker's purchase, it would not be obvious that it was connected to an earlier default, and the hallmark of MTIC trading, as described above, is a default by an acquirer or importer or goods (although, as I have said, the default is not the <u>object</u> of the fraud). A fraudster must realise that if HMRC did not find an earlier default, they would be very unlikely to suspect that the broker's trading was engineered for the purpose of fraud.

22.
The fraudsters then invented a more sophisticated method of distancing the broker from the default. This was to remove the default from the broker's chain. As explained above, although the object of the fraud would be the broker's input VAT (or at least that in cash terms the broker would, relying on a future input tax reclaim, pay more in cash for the goods than he receives), the fraud also relies on the acquirer defaulting on the VAT due on the original acquisition (or pretend acquisition) of the goods. There are two ways the UK acquirer could avoid paying this VAT: the original method was, as already described, to evade the VAT by defaulting and going missing (thus 'missing trader fraud'). Alternatively, it could itself act as a broker (ie a UK despatcher of goods to Continental EU) in respect of *different* goods, and use the input tax claim generated by that sale to offset the output tax liability generated by the acquisition in the first chain.

23.
This second chain, referred to as a 'contra chain' or 'dirty chain' would involve a similar carousel of goods (existent or non-existent) with a default by the UK acquirer. The fraud was fundamentally the same fraud with the same opportunity for profit for the fraudster. But if HMRC looked at the chain of supply down to the original broker they would find that the acquirer (referred to in MTIC speak as a 'contra trader') had not gone missing owing substantial VAT: they would find an acquirer-cum-broker who had completed a VAT return showing output tax netted off against input tax.

24.
However, if HMRC were to trace back the broker transactions which gave the acquirer-cum-broker (the contra trader) its input tax claim (which we will refer to as the 'dirty chain'), they would find that these traced back to a default.

25.
In this case, the allegation is that there were both normal chains involving buffers, contra-trading chains where the contra-traders' broker deals traced back to a default and a third type of chain. That third type is alleged to be where the contra-traders' broker deals traced back to other contra-traders, whose own broker deals traced back to a default. HMRC give this trading the name of 'second line contra-trading'. We consider later whether these allegations are made out at §XXX below.

26.
At root, MTIC fraud involving contra trading (if proved) is the same as ordinary MTIC fraud. The fraudster's object is exactly the same: to induce the broker to pay more for the goods than he receives by relying on a VAT refund from the tax authorities. And the fraud relies on no VAT actually ever being paid to HMRC, whether the default is in the same chain or a different chain. Whether the contra-trader or broker knows (or ought to know) that they are participating in a fraud are questions of fact in any individual case.

‘Acquisition’ fraud

7. But first we describe a simpler VAT fraud, as the appellant’s submissions were in part based on this. The simpler fraud is referred to as ‘acquisition’ fraud. In its simplest form, it is really very unsophisticated. A fraudster sells goods within the UK and absconds (intentionally) without paying to HMRC the VAT due on the sale. This fraud only operates in a genuine market for the goods: the fraudster needs to identify a genuine buyer for the goods so that he can sell to the buyer the goods and pocket the VAT. It’s referred to as ‘acquisition’ fraud because, in order to make the fraud lucrative, it is important to the fraudster that it obtains the goods free of VAT. So, to obtain them free of VAT, the fraudster exploits EU VAT law which provides that cross-border intra EU sales of goods are VAT free (zero-rated). So the fraudster imports them free of VAT from the EU (‘acquires’ in EU speak) and the fraud is referred to as acquisition fraud. We note that it is possible for essentially the same fraud to be committed without an acquisition from the EU, for instance, if the goods can be obtained VAT free within the UK (eg by buying them second hand from unregistered persons) they can be sold on and the VAT retained.

MTIC fraud

8. MTIC fraud is superficially similar to acquisition fraud but in fundamentals very different. Both frauds involve VAT free cross-border sales but MTIC fraud is centred on the law that makes a sale of goods *from* the UK to continental EU zero rated. Traders exporting (‘despatching’) goods to continental EU have to pay VAT to their UK suppliers, but do not charge it to their EU customer. But, as long as they comply with VAT law, such as having proper proof of despatch, they are then entitled to recover from HMRC the VAT paid to their suppliers.

9. MTIC fraud is designed to create a situation where such tax repayments are due, or at least appear to be due, from HMRC. It relies on engineering purchases and sales of goods; unlike acquisition fraud, it does not take place within a genuine market at all.

10. An MTIC fraud therefore involves engineered sales of goods from the UK to another EU country in order to trigger such repayment. For the fraud to be lucrative, however, it would be essential that the purchase of the goods that are to be sold cross-border did not involve a payment of VAT *to* HMRC as that would defeat the object of obtaining a VAT repayment *from* HMRC. So goods to be sold *to* continental EU would also be purchased VAT free *from* continental EU: while this would generate a VAT liability to be paid to HMRC, the acquirer (ie the entity which imports from continental EU) would simply default on it. In this way an MTIC fraud superficially resembles an acquisition fraud: both involve a default by the acquirer.

11. As MTIC fraud requires the UK acquirer to default on its VAT liability, while the UK despatcher (ie exporter to EU) is needed to make the VAT reclaim from HMRC that was the object of the fraud, they could not be the same person. The acquirer was called the ‘defaulter’ by HMRC; the despatcher the ‘broker’. CCA was accepted to occupy the position of the broker in the series of MTIC transactions we describe below.

The carousel element

12. It is easy to see that the identical goods could be used repeatedly in the same MTIC fraud as MTIC fraud involves an entirely artificial market. It would be cheaper for the

fraudster to use the same goods time and time again. The same goods could be sold from the UK to continental EU, from continental EU back to the UK, and then sent round again, each time generating another VAT repayment from HMRC, and each time involving a default by an acquirer. This was why MTIC fraud was often also called 'carousel' fraud: the same goods went round and round, actually or purportedly crossing and re-crossing the Channel many times. As none of the participants in the orchestrated transactions had any interest in the goods the subject of them, it would not matter if the goods were in poor condition from their many journeys nor even if they met their contract description.

Control of the broker?

13. There were two different ways an MTIC fraudster who controlled an artificial supply chain could in theory make its money from the fraud, with any variation in-between the two methods being possible. One method was for the broker to be a VAT-registered entity controlled and funded by the fraudster: the fraudster's profit was quite simply the VAT refund extracted from HMRC.

14. But the fraudster would not necessarily need to control and fund the broker. The fraudster could instead simply identify an independent, VAT registered entity, probably one already in business with a good VAT compliance record, which was willing, and had sufficient funds, to buy the goods acquired by the defaulter and sell them into continental EU. The *net* price of the goods offered to the broker would be lower than the *net* price of the goods at which an EU customer, in the artificial supply chain, would offer to buy them: on paper the broker would make a profit.

15. However, the broker would actually pay more for the goods than it would receive because it would buy the goods *plus VAT* (as it was a UK to UK deal) and sell them to the EU customer *free of VAT* as explained above. The broker would then reclaim from HMRC the VAT it had paid its supplier: only when it received the reclaim, would it be able to realise its paper profit. This would also be true of any business involved in genuine transactions which bought goods in the UK and sold them into continental EU, where the profit margin was less than the VAT.

16. The fraudster's profit, however, was the fact that it received more in cash for the goods than it caused the entity acting as the EU customer to pay the broker for the goods. The defaulter, which directly or through a chain of companies, sold the goods to the broker would receive the cash with the liability to account for the VAT element to HMRC but, as we have said, it would intentionally default on that liability. This was fraud.

17. In this type of MTIC fraud, with an independent broker, the fraudster would control to some extent every entity in the supply chain, such as the defaulter, the broker's supplier and the broker's customer, but would not control the broker. Therefore, the broker, although a crucial part of any MTIC fraud, did not necessarily have to know anything about the fraud: the broker simply had to be someone willing and financially able to buy and sell the goods. The broker might be under the impression it was trading on a genuine market. It might be an established company which was simply duped into participating in an engineered supply chain.

18. It was the appellant's case that, in so far as MTIC fraud was proved in this appeal, CCA had been duped into participating as a broker in an MTIC supply chain. As HMRC did not allege fraud against CCA, we understood HMRC to accept that CCA was independent of the fraudster; it was HMRC's case that CCA nevertheless had participated in the supply chains knowing that they were connected to fraud.

Is the VAT refund important to the fraudster?

19. It is usually said that the input tax reclaim made by the broker is central to MTIC fraud; that is obviously so where the broker is an entity controlled and funded by the fraudster. A circular series of transactions, together with a circular flow of money, is put in place in order to generate the appearance of a genuine trade so that HMRC make a VAT refund in respect of the despatch of the goods to the EU. The object of such a fraud is obviously the VAT refund by HMRC as that is the only money that enters the chain.

20. But, as explained above, where the broker is independent of the fraudster, the fraudster's profit is more subtle. He realises his profit because the broker pays more in cash for buying goods than it receives from selling them. So, in this type of MTIC fraud, is it really true to say that the broker's VAT reclaim is central to the fraud? The fraudster has his profit even if the broker is later refused its VAT reclaim by HMRC. This is the position CCA takes. It says that the fraudster has achieved its profit objective when CCA paid it for the goods: the fraudster would not care if CCA was then refused its refund by HMRC.

21. However, we do not agree that it follows that the fraudster has no interest in whether the broker's subsequent VAT reclaim succeeds. On the contrary, MTIC fraud must be complicated to set up, involving many parties and money movements and the creation of a great deal of paperwork, the movement of actual goods (see §12) and the need to identify a broker who is prepared to participate: the fraudster is likely to want to repeat the fraud as many times as possible to more than recoup the set up costs, so it saves time and effort if he can repeat the fraud with the same parties (and the same goods - see §12). So, it is a logical inference that the fraudster will want the broker's input VAT claim to succeed so that the broker would agree to enter into further transactions. It's a logical assumption that a fraudster would do what it could to ensure that the broker recovered its input tax. Logically this is so even where the broker was entirely independent of the fraudster and using its own cash in the transactions, and even if the broker was entirely unaware of the connection to fraud. Therefore, as a matter of logic we cannot accept the appellant's position that the fraudster was not interested in whether CCA's VAT claims succeeded.

APPENDIX 2: TEXTS OF EMAILS BETWEEN MR TALATI OF DMC ("AT") AND HARALD HAIDER OF ITEM ("HH") OBTAINED BY HMRC FROM AUSTRIAN TAX AUTHORITIES

23 October 2015

AT to HH

"Hi Harald

Pricing attached. As always, let me know what is workable for you.

Thank you."

28 October 2015

HH to AT

"-0,75% and you have a deal

Br"

29 October 2015

AT to HH

"Can we meet in the middle?

So say -0.35%?

Thanks"

30 October 2015

HH to AT

"hi

Shipment date is not a problem when you can do follows for this order.

I prefer the shipment so fast you can, but also is 20 Nov workable

but for this I need follows

the payment terms must be in 2016!

means 20 Nov need 45 days net

or 15 Nov needs 50 days net

or 30 Nov 35 days net

If you can do this we can start with the order

br"

AT to HH

"Hi Harald

Yes this is perfectly understandable for payment dates due to Christmas closure.

We can work with this.

Thanks"

6 November 2015

HH to AT

“Hallo Aziz

Find the new order 5294146

pricelevel is your offer minus -0,6%

as you agree. Payment terms must be in 2016!!!! dependent from the invoice date!

the right terms must stand on the concerned invoice!

minimum 30 days

please confirm

br”

AT to HH

“Hi Harald

Yes, confirmed. Delivery week commencing 23rd Nov. Payment when we return in 2016.

Thank you”

2 February 2016

HH to AT

“Hallo Aziz

find the new Forecast. pricelevel is -6,5% from distri. Please check and come back very urgent. but first give me a feedback for the inquiry. if we get the order, qty can by changing

br”

31 March 2016

HH to AT

“hallo aziz,

need the 6,5% please check and do your best”

AT to HH

“Can we meet in the middle…anywhere

Let me know

Thanks”

HH to AT

“sorry need the 6,5%”

AT to HH

“6.75%??

Well I have to try … Ok, send me the schedule you would like for the delivery for 6.5%

One day Harald … one day I hope to make you move a little ;)

Thanks”

HH to AT

“the pricelevel is 6,5%!!!!

if you make the 6,50 you will get the whole order in the excel file

but I will also take 6,75% :-)))

br”

AT to HH

“Haha, I meant 6.25%!!!!

Ok, send for 6.5”