[2022] UKFTT 00020 (TC)

TC 08373/V

Keywords: Missing Trader Intra Community ("MTIC") fraud in Electronic Communication Services ("ECS"), Whether the Appellant knew or ought to have known that the relevant transactions were connected with fraud. Held: no. Axel-Kittel v Belgium; Belgium v Recolta Recycling [2006] ECR 1-6161 and Mobilix Ltd (In Administration) v HMRC; HMRC v Blue Sphere Global Ltd,; Calltel Telecom Ltd and another v HMRC [2010] EWCA Civ 517 considered and applied.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/02223

BETWEEN

PTGI-ICS LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE ASIF MALEK
JANE SHILLAKER

The hearing took place between 3-21 September 2021. The form of the hearing was V (video) via the Tribunal video platform and all parties, witnesses and representatives attended remotely. A face-to-face hearing was not held because it was just, proportionate and in the interest of justice for the hearing to be conducted by video. The documents to which we were referred are the hearing bundle, various legal authorities and the skeleton arguments of the parties.

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.

Mr Bedenham, of counsel, for the Appellant

Ms. Robinson and Ms. Udom, of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTIONAND PROCEDURAL BACKGROUND

1. The Appellant appeals against the Respondents' decisions: (1) dated 20 February 2017 denying the Appellant's right to deduct input tax in the sum £13,752,097.30 claimed in VAT periods 06/15, 09/15 and 12/15, and (2) dated 18 August 2017 denying the Appellant's right to deduct input tax in the sum of £5,416,055.69 claimed in VAT period 03/16 on the grounds that the input tax was incurred by the Appellant in transactions connected with the fraudulent evasion of VAT and the Appellant knew or should have known of this fact.

2. Both appeals (TC/2017/02223 and TC/2017/06756) were consolidated under reference TC/2017/02223 by direction dated 8 December 2017.

THE GROUNDS OF APPEAL

3. The Appellant appeals the decisions and asks this Tribunal to discharge the assessments on the grounds that:

(1) the Respondent is required to prove, and has not done so, that there was fraudulent evasion of VAT.

(2) the Appellant neither knew nor ought to have known that the transactions were connected with the fraudulent evasion of VAT.

THE LAW

4. There is no dispute between the parties in relation to the applicable law which we summarise in Appendix 1.

THE ISSUES

5. The questions for our consideration are:

(1) Is there a tax loss? (The tax loss question)

(2) If so, does the tax loss result from fraudulent evasion? (The fraud question)

(3) If there is fraudulent evasion, were the Appellant's transactions connected with the fraud? (The connection question)

(4) If they were connected, did the Appellant know or should the Appellant have known that its transactions were connected with fraud? (The Knowledge Question)

6. The Respondents accept that the burden of proof is on them and that the standard of proof is the balance of probabilities.

7. The Appellant's position on the issues is set out in the Notice of Issues. The Appellant accepts:

(1) The accuracy of each transaction chain as set out in the Respondents' witness evidence;

(2) That there is a tax loss at the start of each transaction chain; and

(3) That the tax losses are attributable to the fraudulent evasion of VAT.

8. The Respondents position is that all four questions, detailed at paragraphs 5 above, should be answered in the affirmative and, consequently, that the right to deduct input VAT in relation to these transactions is lost.

9. It follows, therefore, the focus of this appeal is on the Knowledge Question.

THE EVIDENCE

10. As is usual in these cases we had before us a voluminous amount of documentary evidence contained in over 12 electronic bundles.

The Respondents' evidence

11. The Respondents relied upon witness statements produced by:

(1) Officer Gary Saul,

(2) Officer James Mullen,

(3) Officer Marva Harry,

(4) Officer Gavin Stock,

(5) Officer Andy Monk, and

(6) Officer Julie Yeomans.

12. The evidence of Officers Mullen, Stock, Monk, Yeomans and part of the evidence provided by Officer Saul was not challenged. The first four officers were not required to give oral testimony. This evidence related to the tax loss, fraud and connection questions and can be summarised as follows. In each of the 20 deal chains that this appeal concerns itself with the Appellant was supplied with Electronic Communication Services ("ECS") by either Ikarim Business Services Ltd ("IKB") or Indigo 11 Services Ltd ("Indigo"). In appendix 2 we reproduce the "deal chain" provided on behalf of the Respondents which summarises the link between the defaulting trader and either Indigo or IKB. From this document we can see that for the deal chains in question Zambezi Ltd, Presence Networks Ltd, Slingtel Limited, Business Network Management Ltd and Stock & Asset Management Ltd are identified as the defaulting traders (the "Defaulting Traders"). The evidence of Officers Mullen, Stock, Monk, Yeomans and Saul demonstrates on the balance of probabilities that there was a tax loss occasioned to the Respondents by the Defaulting Traders, that such loss was as a result of fraud and that, in each case, it was connected to the Appellant by virtue of either IKB or Indigo.

Respondents' witnesses giving oral testimony

13. Officers Saul and Harry gave oral evidence before us and adopted their witness statements. Both were cross-examined by Mr Bedenham on behalf of the Appellant and there was also an opportunity for us to ask questions.

Officer Harry

14. Officer Harry's evidence can be summarised as follows:

(1) She is an officer of HMRC having worked for the Respondents since September 1987. Since May 2006 she has worked within a team dealing with suspected MTIC fraud.

(2) IKB was incorporated on 12 January 2011 with Mr Ifthakhar Karim appointed as a director on the same day. He continued as a director until 11 May 2015. Mr Mohammed Shakeel Mughal was appointed as a director on 4 December 2013 and was a director at all relevant times. As at 12 January 2016 Mr Mughal was the sole shareholder.

(3) IKB was registered for VAT on 12 January 2011 and, thereafter, rendered quarterly returns. The returns for the periods 04/15 and 07/15 declared sales of £12, 471,769 and £19,332,684.

(4) On 16 October 2013 Officers Monk and Dixon visited IKB at its place of business when Mr Karim told them that the business of the company included working as a contractor for Cisco and providing airtime. The latter part of the business provided around 20 million minutes per month with routes to Africa, Algeria and Belarus.

(5) Officer Monk provided a summary of the meeting by letter dated 18 October 2013 and enclosed a copy of Notice 726.

(6) Officer Monk wrote to IKB on 1 December 2013 about its proposed due diligence process saying:

> "In respect of your proposed due diligence checks, these should be undertaken to allow you to make an informed commercial decision, regarding prospective trading partners; any regime that you put in place should be used in conjunction with looking at the nature of the deals being proposed. Unfortunately, there is a significant amount of VAT fraud present within the trade sector that you operate in and this should always be kept in mind…
>
> The checks you have proposed should help assure you that direct trading partners exist and are registered for VAT at that particular time, however, that in itself should not be looked upon as a guarantee that the prospective deals and the companies involved are not facilitating a fraud. The most stringent test you can apply is to ask yourself if a deal is commercially viable and that there is a bona fide commercial reason for it to occur…
>
> During our meeting you explained to me that the source telecoms providers will not deal directly with small players and that it is this fact which drives the supply chains in the airtime markets, with smaller companies obtaining minutes from larger companies. Credit checks and checks via Companies House should be able to tell you how long a company has been trading and the general size of that company, in such circumstances you should therefore question the commerciality of small newly formed companies selling you minutes at a competitive price as they should be operating at the same level as yourselves as a relatively new player in the market.
>
> A normal free market dictates supply chains are as small as possible as each link in a chain increases the price of the product, resulting in superfluous links in a supply chain pricing a product out of the market. It is in the nature of Missing Trader fraud that a considerable number of companies will trade goods and services in an extended supply chain, which is why you should carefully examine deals in order to assure yourself that there is a genuine commercial purpose behind any deals that you are offered.
>
> An explanation of 'somebody wanted to sell something and somebody wanted to buy it' would not be considered a sufficient rationale given the degree of fraud that exists in the market today."

(7) On 28 November 2013 Officer Monk and Harry visited IKB when they met with Mr Karim and Mughal. The latter described himself as "*the technical services manager whose primary role is to manage the Switch, setting up interconnections, trouble finding, trouble shooting and planning traffic routes*". He also said that he had 19 years in telecommunications, in Tandberg, a Norwegian company taken over by a Cisco-uniformed company. The directors also gave the following information:

(a) That IKB was about to purchase its own Switch;

(b) The IT consultancy side of the business was now under the name of VAT registered company Kashi Ltd run by Mr Karim and his wife (VRN 180 2137 38);

(c) The increase in outputs is due to the EU supplier in Portugal; and

(d) The company had not traded with any new customers or suppliers since the last visit.

(8) Visits were made to IKB on a monthly basis thereafter, as part of the Continuous Monitoring Project. On 31 January 2014, Officers Harry and Airen conducted the visit. On that occasion, they met Mr Karim and Mr Mughal who informed them [RWS3/146]:

(a) Mr Mughal was now a company director and held 50% of the shares;

(b) The company was now routing calls through Pakistan, as of January 2014, IKB having come by this route through Overseas Communications, a company which had been both supplier and customer;

(c) R&R had only provided the Switch from 3 December 2013; prior to that, SABA VoIP had provided the Switch;

(d) On being asked why payments from Overseas Communications were not visible on the bank statements, that was because of the 'Bilateral Agreement' and payments being offset.

(9) Officer Harry discussed "at great length" the due diligence performed by the company, and informed the directors that she had reasonable grounds to suspect that at least two supply chains traced back to a defaulting trader; further, most of the company's suppliers for period 10/13 were now de-registered.

(10) On 27 February 2014, Officers Harry and Dixon met Mr Karim and Mr Mughal. The directors told the officers [RWS3/150] that the company had not traded with any new customers or suppliers since the last visit.

(11) On 27 March 2014, Officers Harry and Dixon attended IKB's principal place of business and spoke with Mr Karim Fand Mr Mughal [RWS3/154]. The directors told the Officers that IKB was potentially looking to do business with Route Trader and "Indigo Services Ltd" (VRN 171 1267 31).

(12)On 30 April 2014, Officers Harry and Coker visited IKB and spoke with Mr Mughal and Mr Karim [RWS3/157]. Officer Harry informed the directors that she would be issuing a tax loss letter for period 01/04, with defaults in the supply chain in that period.

(13)On 29 May 2014, Officers Harry and Coker conducted a further visit to IKB, and spoke with the directors.

(14)On 26 June 2014 [RWS3/164], Officers Harry and Akinwunmi visited IKB and spoke to both directors who said that IKB used the services of PTGI (later confirmed to be CTM), a due diligence company said to employ a former HMRC employee.

(15) On 31 July 2014, Officers Harry and Dixon met with Mr Mughal and Mr Karim at the place of business [RWS3/167]. The directors told the officers that IKB had signed a NCD (clarified at a subsequent meeting to be a 'non- circumvention/non-disclosure agreement) with a huge US company named Verizon, via the HQ for Europe based in Reading (Verizon UK Ltd, VRN 823 8170 33). VoIP Capital would factor the whole deal, and would pay IKB daily, and collect payment from Verizon after 30 days. However, the directors continued that Verizon insisted on paying IKB directly and IKB looked to set up an offshore account with Cidel Bank & Trust in Barbados, VoIP Capital having recommended Cidel to IKB. Indigo was a potential customer, and some testing had been done two weeks previously on Bangladesh routes; PTGI was said to be based in the US, with an office in East London.

(16)On 28 August 2014, Officer Harry visited IKB and spoke with Mr Mughal and Mr Karim [RWS3/181]. The monthly records revealed transactions between IKB and PTGI.

(17)When asked, during the September 2014 visit, Mr Mughal said that IKB had traded with PTGI since June 2014 [RWS3/186].

(18)At a visit conducted on 23 October 2014, the directors told Officers Harry and Dixon that two new US$ accounts had been opened for the new transactions, with DMS Bank having been recommended by Talking Capital. Third party access to the DMS account was to be provided. The October transactions would reflect trading with Talking Capital but IKB was reliant on Barclays Factoring Company. [RWS3/188].

(19)On 26 November 2014, [RWS3/194] Mr Mughal and Mr Karim told Officers Harry and Elijah that PTGI would not use DMS bank but would be prepared to do the factoring using a UK bank account through which they would only pay IKB.

(20)On 22 December 2014, the directors told the officers that Verizon had currently terminated traffic with IKB while further due diligence was carried out on the company.

(21) On 28 January 2015, Officer Harry noted [RWS3/205]:

> "With PTGI…looking at seven day invoicing and looking to enter into factoring deals using Talking Capital, I have requested sight of the factoring agreement, this expected by Monday 2 February 2015. Routes through PTGI are African routes, Zambia, mostly Pakistan, UAE and Bangladesh. The new routes on the 30 day contract will be Gambia, Senegal tested yesterday and Liberia.
>
> The payment terms are that Talking Capital will pay IKBS into their InterSwitch account (Verizon deals) and PTGI to pay Talking Capital through First Republic, a private American bank (First Republic BK Wire Operations). This appears to be a complete turnaround for PTGI who previously were only prepared to utilise a UK bank account from which they would only pay IKBS."

(22) On 11 March 2015, Officers Harry and Airen visited IKB's premises as part of the Continuous Monitoring Project [RWS3/209]. The directors told the officers

the UK branch of Verizon now has all IKB information, but has requested proof that IKB files its VAT returns.

(23) On 24 March 2015, Officer Harry delivered a tax loss letter in respect of the 10/13 period [RWS3/213]. T

(24) At a meeting with Officers Harry and Akinwunmi on 29 April 2015, the directors said that transactions in April 2015 were undertaken with PTGI. The directors reported that "Craig Danson" had asked whether the company paid its VAT over.

(25) On 11 May 2015, Officer Harry received an email from Mr Karim which informed her that he had decided to leave the company and had resigned as a director [RWS3/219].

(26) On 25 June 2015, Mr Mughal informed HMRC officers that he would be travelling to the USA on 9 July 2015, as part of IKB's due diligence checks on PTGI. He said that he would meet Mr Denson (CEO of PTGI) for a meeting with the Hc2Group in New York [RWS3/222]. Mr Mughal also confirmed that PTGI was the only customer in June 2015, with Presence Networks, Slingtel and TW the suppliers. Mr Mughal also said that he would meet Rodney Omanoff from Talking Capital whilst there.

(27) Officers Airen and Harry visited IKB on 30 July 2015 [RWS3/224]. Mr Mughal said that he had met with Mr Denson and Mr Chee from PTGI earlier in July, and also Rodney Omanoff from Talking Capital. The meetings had been conducted for due diligence purposes. Mr Mughal had told PTGI that it engaged CTM to carry out its due diligence.

(28) Officers Dixon and Harry visited IKB on 20 August 2015. A record of the meeting provides:

> "… On this particular payment PTGI had paid Talking Capital (factoring company) directly (the Orange County Switch is for the billing). IKBS then pay their suppliers from the Telfinance account. …I have requested Talking Capital's statement of payments (breakdown) for July 2015 once it has been completed. Also obtained copy of the Daily Statement No 20150714/102771 from IKBS to PTGI. IKBS payment will always be 5.5% less than the amount shown on the invoice, as shown on the reimbursement calculation for 13/07/15."

(29) On 27 October 2015, during a visit under the Continuous Monitoring scheme, Mr Mughal told the officers that Mr Danson from PTGI would be visiting IKB on 30 October 2015 [RWS3/261]. He said that the volume of traffic through PTGI had increased with one switch unable to deal with the recent capacity.

(30) On 26 November 2015, IKB informed HMRC that its only customer was PTGI and its suppliers were Presence Network Ltd and Stock and Asset Management Ltd. The visit report records [RWS3/265]:

> "During our conversation, Mr Mughal advised me that he had received an email from PTGI concerning tax losses in their supply chain and talk of terminating their contract. Mr Mughal was concerned that the seeds of doubt was being planted with their biggest client but stated that he hadn't wanted to take the matter further. Mr Mughal stated that he had contacted all his suppliers and none of them were aware of any tax losses. Hence Mr Mughal reluctance to disclose his potential client because of pending tax loss letter in

> period 07/15. We spoke about due diligence, applying his knowledge of the trade sector to the company reports he pays for and that due diligence was an ongoing process. After seeking advice, Mr Mughal stated that enhanced checks will be undertaken. I explained how MTIC fraud occurred within a supply chain and explained that the default may not lie with their immediate suppliers…

(31) During a visit to IKB on 29 December 2015, Mr Mughal confirmed that PTGI remained IKB's only client at that time and Stock and Asset Management was IKB's only supplier [RWS3/269]. Mr Mughal also said that CTM had ceased working for IKB, because it had started working for PTGI and considered there to be a conflict of interest in working for both companies.

(32) On 27 January 2016, at the visit conducted with IKB, Officer Harry recorded the following [RWS3/273]:

> "Further to discussion with Craig at PTGI and advice taken from Matt Blake at Bedrock [CTM's replacement] under the terms and conditions IKBS had terminated their contact with PTGI on 25 January 2016. Mr Mughal stated that PTGI had clawed back VAT estimated around US$250,000. It was suggested that IKBS may want to obtain a written letter from PTGI as it was said to be in regards to the reverse charge. As Mr Mughal was aware, and reminded, that does not actually come into effect until the 1 February 2016. On legal advice, a notice of termination, under clause 10 of the agreement and final invoices has been sent from IKBS to PTGI."

(33) Mr Mughal told HMRC officers, on 2 March 2016 that:

(a) Given that no trade had taken place in February 2016, IKB were still hoping to trade with PTGI in the future even though their relationship had broken over the cancelled contract and non-payment.

(b) The PTGI payments for factored traffic was $23,000,000, and the non-factored around $830,000. The non-factored payment was received by IKB on 29 January or around that date through the US Barclays dollar account. Factored traffic 30 x 30 invoiced on 25/1/16 to Talking Capital (Rodney) who then pays IKB on a daily basis. Mr Mughal is not sure whether Talking Capital was in receipt of money although he had talked to Rodney yesterday. The payment to Talking Capital from PTGI is made around the second or third day of every month.

(34) The company was de-registered for VAT with effect from 5 May 2016 [RWS3/284].

Officer Saul-Indigo

15. Officer Saul's evidence can be summarised as follows:

(1) He is an experienced Higher Officer of HMRC. He is the assigned officer for Indigo.

(2) Indigo was incorporated on 30 May 2012, under company number 08088170 [RWS4/27]. On the same day, Mr Nazmal Hoque was appointed director of the company. Mr Hoque is the only person to have been a director of the company [RWS4/28].

(3) On 30 September 2012, HMRC received an electronic application to register for VAT. Indigo was registered with effect from 1 October 2013 under VRN 171 1267 31 and rendered quarterly returns.

(4) On 17 April 2014, Officers Monk and Dixon conducted an unannounced visit to Indigo's place of business. The visit was undertaken because IKB had contacted the Respondents in order to verify Indigo's VRN [RWS4/43]. During the visit Mr Hoque said that his company had not yet undertaken any deals, but was looking to trade in three areas: wholesale airtime carrier; retail VoIP provider; and money transfer platform. The company wished to deal wholesale between tier one companies and wholesale customers. Mr Hoque said that he had contacts in the industry who would help him start out. He had been in discussions to trade with IKB. Mr Hoque said that he was an IT consultant/investment banker by profession, and had a PhD in artificial intelligence. He had been encouraged to enter the sector by friends in the airtime business who said that there were good opportunities in that field.

(5) On 23 April 2014, an MTIC awareness letter was issued to Indigo [RWS4/50].

(6) On 5 June 2014, Indigo was put on the Continuous Monitoring Programme.

(7) On 19 June 2014, Officers Samuel-Blatch and Yusuf visited the company's place of business [RWS4/66]. Mr Hoque confirmed that Indigo had not commenced trading. Mr Hoque was again provided with a copy of Notice 726.

(8) On 6 November 2014, Officer Samuel-Blatch conducted an arranged visit at Indigo's place of business.

(9) On 12 January 2015, the Respondents sent an Alternative Banking Platforms letter to Indigo at its place of business. A further letter dated 12 January 2015 was sent to the Indigo to advise on risks associated with MTIC fraud, and procedures for validating VAT registration details of trading partners with HMRC [RWSS4/58].

(10) On 28 January 2015, Officer Samuel-Blatch carried out a visit to Indigo's place of business and met with Mr Hoque.

(11) On 25 February 2015, Officers Samuel-Blatch and Patterson met with Mr Hoque.

(12) On 24 March 2015, Officer Samuel-Blatch visited Indigo's place of business. Mr Hoque said that PTGI was a potential new customer but he "*is not sure*". PTGI is in the UK, but the parent company was US based. The companies had agreed routes to Somalia and Zimbabwe. PTGI wanted to trade volumes, but finance was an issue. Mr Hoque had been put in touch with Talking Capital who paid suppliers, took a percentage and collected money from customers.

(13) On 28 May 2015, Officer Samuel-Blatch visited the company's Principle Place of Business ("PPOB") [RWS4/168]. He discussed potential new customers, one of which was said to be Open House Facilities Ltd.

(14) On 8 December 2015, Officers Samuel-Blatch and Saul visited Indigo's place of business, but were taken to the Hilton Hotel by Mr Hoque [RWS4/187]. Mr Hoque confirmed his customers to be PTGI, Tata and Universal Call. Mr Hoque said that he had engaged CTM to conduct due diligence enquiries in respect of Indigo's trading partners. Mr Hoque said that he had stopped trading with Open House Facilities Ltd, as he considered the director, Mr Kamaly, too pushy in terms of payment. He said that payments to Open House had been made via the Telefinance platform. Officer Saul

said that the director of Open House Facilities Ltd denied that any transactions had taken place. Mr Hoque said he would provide copies of all communications with Open House Facilities Limited and BNM, and signed agreements.

(15) Between 8 December 2015 – 10 June 2016 Indigo received three tax loss letters from the Respondents.

(16) Between 24 August 2015 – 19 January 2017 Indigo received a number of failed VRN check letters from the Respondents.

(17) On 3 February 2017, the Respondents notified Indigo of their decision to deny input tax in respect of transactions in periods 06/15 (£1,304,412.22), 09/15 (3,995,081.71) and 12/15 (£4,172,953.73), it having been established by that point that 127 of 187 transactions in those periods commenced with a tax loss and fraudulent defaulter [RWS4/214]. This letter was subsequently amended to include further information about the right to appeal against the decision [RWS4/223]. The deals with PTGI were included in the 'denied deals'.

(18) Indigo appealed against the decision to deny, on 19 July 2017 [RWS4/13].

Officer Saul - PTGI

(19)He is also the officer assigned to the Appellant, PTGI. PTGI was registered for VAT on 31 July 2012 under VAT registration number 135 5476 06.

(20)On 6 May 2014 PTGI was selected for the MTIC continuous monitoring programme.

(21)On 8 May 2014 Mr Meloni, of PTGI, called him to discuss the extended verification for PTGI's claims. There then followed an exchange of emails and telephone calls seeking and providing further information, culminating in a tax loss letter sent to PTGI on 11 August 2014 relating to transactions carried out with Parkwell Investment Limited. The information passing from the Respondents to the Appellant included a copy of a VAT Fraud Alert: Alternative Banking Platforms letter.

(22)On 14 August 2014 he received two telephone calls from Mr Meloni regarding the tax loss letter. During the second call Mr Meloni said that Parkwell Investment Ltd had now set up under the name IKB services.

(23)On 10 September 2014 he discussed due diligence relating to PTGI and Arbinet-Thexchange Ltd ("Arbinet") with Mr Meloni over the telephone. He then discussed due diligence with Mr Meloni again on 13 November 2014 when Mr Meloni said that their due diligence procedures had changed and requested that Officer Saul examine this beforehand. Officer Saul said that this was a business decision for PTGI.

(24)On 29 January 2015 he received advice from the Technical and Policy teams to the effect that the transactions did not commence with a fraudulent default and loss in the period 03/14. He authorised the release of the repayment claim for the period 03/14 on 9 February 2015.

(25)On 25 June 2015 he carried out a visit at the Appellant's principle place of business when he met Mr Faisal Hayat. He discussed the extended verification process and due diligence procedures with him. He also provided a copy of VAT Notice 726.

(26)On 13 August 2015 he caried out a further visit and again spoke to Mr Hayat. He explained that the claim for VAT period 06/15 was under extended verification and

asked about the increased sales from the previous period. Mr Hayat said that amongst the new suppliers were IKB and Indigo. The Appellant's due diligence procedures were discussed and Mr Hayat informed him that Mr Liban Ahmed of CTM had been employed to carry out due diligence.

(27) On 29 September 2015 he, together with Senior Officer Outram, visited the Appellant and met with Mr Hayat and Ms. Alison Clarke. Due diligence and the Kittel decision were discussed.

(28)On 19 November 2015 he, together with Officer Ballester, carried out a visit at the Appellant's premises and met with Mr Hayat. They discussed the transactions involving IKB and Indigo. He confirmed that tax losses had been established in supply chains involving IKB and Indigo, but had not established that they were connected with the Appellant. Mr Hayat said that Mr Denson, the Appellant's CEO, had recently met with the directors of IKB and Indigo.

(29)On 10 December 2015 he issued a tax loss letter in relation to Indigo in the sum of £1,994,005.37.

(30)On 2 February 2016 he, together with Higher Officer Baltruschat, visited the Appellant and met with Mr Hayat. During this meeting he asked Mr Hayat about the action it had taken since receiving the tax loss letter of 10 December 2015. Mr Hayat said that he had contacted the director of Indigo who had told him that the tax loss occurred downstream. Mr Hayat had also contacted CTM who had recommended another due diligence company called Bedrock. He also asked about the payment arrangements with Indigo as payments appeared to be made via Talking Capital Bank. He also re-iterated his concerns in the supply chain with Indigo and Ikarim. He discussed the reverse charge mechanism and provided copies of VAT Notice 735.

(31)On 4 October 2016 he, together with Officer Allcock, visited the Appellant. They met with Mr Hayat and the Appellant's representative Mr Liban Ahmed of CTM.

(32)On 20 February 2017 he issued a "*means of knowledge decision letter*" denying input VAT to PTGI for the periods 06/15, 09/15 and 12/15 on the basis that the transactions in question with Indigo and IKB were connected with tax losses, blocking buffers and fraudulent traders. The amounts denied were as follows:

(a) 06/15 - £4,926,482.54
(b) 09/15 - £3,755,561.36
(c) 12/15 - £5,070,053.42

(33) On 18 August 2017 he issued a "*means of knowledge decision letter*" to deny the input VAT claimed by PTGI for the period 03/16 on the basis that the transactions with Indigo and IKB were connected with tax losses, blocking buffers and fraudulent defaulters. The amount denied was £5,416,055.69.

16. Officer Saul was cross examined extensively and our findings on any contentious part of his evidence are set out under the heading 'Findings and discussion' in this judgement.

Appellant's evidence

17. The Appellant sought to rely upon witness statements made by:

(1) Mr Craig Denson,

(2) Mr Liban Ahmed,

(3) Mr Robert Meloni,

(4) Ms. Alison Clarke, and

(5) Mr Faisal Hayat.

18. Mr Meloni, Ms. Clarke and Mr Hayat did not attend to give oral evidence at the hearing despite having made witness statements and being aware of the date(s) of the hearing. We note that Mr Hayat's statement in our bundle is unsigned. It was common ground that the fact that these witnesses did not give oral evidence went to the weight that we gave to this evidence and not admissibility. We accept the Respondents submissions that we should give little weight to this evidence. This is because the statements were not made contemporaneously and in the case of Mr Hayat not signed by him. In addition, there was, of course, no opportunity to cross examine any of the makers of these statements and no opportunity for us to ask questions or observe these witnesses for ourselves.

19. The Respondents go further and invite us to draw inferences from the non-attendance of these witnesses and make findings of fact adverse to these witnesses. After careful reflection we have concluded that the potentially detrimental effect of any adverse inferences, even if we were to make them, in relation to these witnesses would be nullified by reason of the explanation provided. This is because we accept the explanation provided on behalf of the Appellant that these witnesses are no longer employed by the Appellant (in the context where the Appellant is no longer trading) and, therefore, no longer have any reason or desire to give evidence in circumstances where giving such evidence may well necessitate unpaid time away from their new employment and inconvenience to themselves.

20. It is also suggested by the Respondents that we should draw adverse inferences from the fact that Mr Hoque and Mr Moghul were not asked to provide statements by or give evidence on behalf of the Appellant. The reason, it was suggested, why the Respondents could not call Mr Moghul or Mr Hoque for themselves was because a '*party ought not to advance before the Tribunal, in support of its own case, any witness it does not regard as credible or reliable*'. That is to say that '*the "calling party" cannot impugn its own witness*'. If that is right then that is also a good reason as to why the Appellant does not rely upon the evidence of Mr Moghul or Mr Hoque. Part of the Appellant's case is that if IKB, Indigo, Mr Moghul or Hoque were involved in a fraud on the Respondents then Mr Hoque and Mr Moghul were effective confidence tricksters. Putting such a case to either Mr Hoque or Mr Moghul would necessarily involve impugning their credibility.

Appellant's witnesses

21. Mr Denson and Mr Ahmed both adopted their witness statements and gave oral evidence. Both were cross-examined by Ms. Robinson on behalf of the Respondents and we had an opportunity to ask them questions. We also note, for completeness and so that it does not cause any confusion in this judgment, that Mr Liban Ahmed is also the Appellant's representative in this hearing.

Mr Denson

22. Mr Denson's evidence can be summarised as follows:

(1) The Appellant, then known as Primus Telecommunications Limited, was incorporated on 8 June 1994. It changed its name to PTGI International Carrier Service Limited on 20 September 2013.

(2) At all material times the Appellant was wholly owned by its US parent company, PTGI-ICS Inc, (renamed HC2 Holdings, Inc on 14 April 2014), a public company laterally listed on the New York stock exchange.

(3) He has been a director of the Appellant since 16 August 2013. However, he has had oversight of the Appellant's business since June 2012 by virtue of the fact that he was the CEO of the Appellant's parent company.

(4) Historically the Appellant was a global telecommunications company with both a retail and wholesale arm. The retail arm concentrated on selling pre-paid telephone cards to individuals via a network of distributors and the wholesale arm concentrated on purchasing minutes which were used for the retail arm and for arbitrage trading.

(5) In early 2011 the Appellant purchased Arbinet and the two entities were operationally merged on 1 October 2013. Arbinet had focussed on wholesaling airtime with a product called the "Exchange". This was, effectively, an automated system allowing telephone operators to connect and trade with each other without any human intervention. The "Exchange" itself consisted of a "Public Exchange" where all members participated and traded and a "Private Exchange" where parties could decide who participated. The "Exchange" was closed on 30 September 2013 and the remaining, profitable accounts moved over to the Appellant's operating system.

(6) Until it ceased to trade in 2016 the Appellant provided transit of airtime calls from one entity to another. The Appellant's business worked because it had good working relationships and connections with Tier 1 companies (such as BT) and smaller niche specialised Tier 3 companies. In essence the Tier 3 companies had access to cheap routes because of their knowledge and connections in the local market which Tier 1 companies did not have. However, the Tier 1 companies will, generally, not deal with a Tier 3 company. This creates an opportunity for the Appellant to, effectively, buy airtime from a Tier 1 company and sell it to a Tier 3 company and vice versa (or buy and sell airtime to another Tier 2 or Tier 3 company). The margins, at less than 2%, are small and volume large. The Appellant regards itself as a Tier 2 company.

(7) Calls received are passed to a supplier through a "switch". The switch routes calls based upon instructions from the billing and routing system. The system monitors credit exposure and automatically finds routes that offer the best price for the required destination based on quality and programming metrics.

(8) The Appellant entered into written agreements with all of its suppliers. It entered into a carrier service agreement dated 2 July 2014 with IKB. This agreement was amended on 13 October 2014 and 12 January 2015. The Appellant entered into a new carrier service agreement with IKB on 19 January 2015 after the parties entered into a factoring arrangements with a third party called Talking Capital. This latter carrier agreement was amended on 11 August 2016. Both agreements were terminated by notice provided by IKB on 25 January 2016. The Appellant also entered into a carrier service agreement with Indigo on 2 March 2015. The parties enter into a factoring arrangement with Talking Capital on 9 March 2015 and the carrier service agreement was amended on 28 May 2015. The Appellant and Indigo enter into a new carrier service agreement on 14 August 2015 and the agreement(s) were terminated by notice provided by Indigo on 25 January 2015.

(9) The senior staff dealing with UK traffic were:

(a) Alison Clarke – head of UK sales and responsible for due diligence on suppliers such as IKB and Indigo,
(b) Patrice Fearon- contract manager based in the USA, and
(c) Robert Meloni- head of tax and based in the USA.

(10) He instigated a meeting with the Respondents which took place in September 2012 because the Appellant was owed more than £2m in VAT refunds. During this meeting he was informed that the "Private Exchange" was high risk regarding VAT fraud.

(11) He was aware of possible tax loss notifications in 2 or 3 cases over the 3 year period, but these were for small amounts and, in the end, the input tax claims were paid in full by HMRC. He says that this signifies that the Respondents must have ultimately concluded from that there was no connection with fraud. He believed that HMRC would notify the Appellant if there was fraud in the Appellant's supply chain given that the Respondents were reviewing it.

(12) He wanted to increase due diligence from 2012 and wanted to be hands on. This was not only because it not acceptable for the Appellant to be complacent about fraud from an ethical standpoint, but also because of the substantial financial penalties and loss of large VAT repayment claims. He oversaw the increased due diligence effort and worked internally with Ms. Clarke and Mr Hayat to improve procedures.

(13) He met with Mr Hoque of Indigo in June 2015. He felt that Mr Hoque was smart and experienced in telecoms.

(14) In early June 2015 he also met Mr Ahmed, of CTM. He understood from Mr Ahmed that he had worked for HMRC for many years specifically tackling Missing Trader Intra Community ("MTIC") fraud and felt that he would be a perfect match for the Appellant in order to enhance its due diligence.

(15) On 9 July 2015 he met Mr Mughal of IKB in New York. The meeting was also attended by Mr Omanoff of Talking Capital. He felt that Mr Mughal was experienced in the telecommunications industry, and he came across as a professional businessman.

(16) On 19 November 2015 HMRC, during a VAT visit, indicated to Mr Hayat that tax losses may be connected to IKB and Indigo. Mr Hayat relayed this message to him on the same day. Mr Denson then emailed Mr Mughal who gave him assurances that any tax losses were historical and unrelated to the trade with PTGI and that he would raise the issue with his HMRC officers on their next visit on 26 November 2015.

(17) Shortly after this visit he instructed Mr Ahmed to visit both IKB and Indigo.

(18) On 27 November 2015 Mr Mughal emailed Mr Denson to say that he had had his meeting with HMRC and that there is "*no tax loss letter being sent or prepared*".

(19) On 19 November 2015 Mr Denson also contacted Mr Hoque about potential tax losses connected with Indigo. Mr Hoque gave him assurances that he was unaware of the issue and that his suppliers were still in place after two years and that he would ask his suppliers to make their own enquiries.

(20) On 30 November 2015 Mr Hayat emailed Officer Saul to ask him to put his concerns in writing. Officer Saul responded the following day to say that he was not yet in a position to issue any tax loss letters.

(21) Upon receipt of a tax loss letter regarding Indigo, on around 10 December 2015, Mr Denson's first reaction was to tell Mr Hoque that PTGI would stop trading with Indigo.

23. Mr Denton was cross examined extensively and our findings on any contentious part of his evidence are set out under the heading 'Findings and discussion' in this judgment.

Mr Ahmed

24. Mr Ahmed's evidence can be summarised as follows:

(1) He is the director of CTM, and he specialises in managing MTIC appeals and conducting due diligence to reduce the risk of a connection with fraud. He was previously an officer of HMRC (as it is now called) and held roles which included investigating MTIC fraud.

(2) He was first contacted on behalf of the Appellant by Mr Hayat on 2 April 2015, had a telephone conference with Mr Denson and Mr Hayat on 8 April 2015 and then met with Mr Denson, Mr Hayat and Mr Chee on 7 May 2015 in order to discuss the services that he could offer to the Appellant.

(3) On 13 May 2015 the Appellant gave him access to their due diligence files on IKB, Indigo and another company.

(4) IKB was a prior client of CTM, and he first met the directors, Ifthakhar Karim and Shakeel Mughal, on 1 May 2014 when he was conducting a due diligence check on IKB on behalf of another client. Mr Ahmed also attended at IKB's office later in 2014 to review the due diligence systems and suggest improvements, but only provided verbal advice and did not keep a note of the meeting as he was not instructed to do anymore.

(5) He later visited IKB on behalf of the Appellant on 7 July 2015 and provided an updated report incorporating his earlier report of 1 May 2014. His report of 1 May 2014 summarised that he saw only positive factors and did not see any reason not to trade with IKB. His updated report of 7 July 2015 highlighted a number of changes including the resignation of one of the directors and a rapid increase in turnover.

(6) He first became aware of Indigo on 22 May 2015 when he was instructed to carry out a due diligence visit on the company on behalf of the Appellant. He met with the director, Mr Hoque, on 30 May 2015 and produced a report in which he summarised the risks posed by Indigo to be low, but that the Appellant should review their due diligence quarterly.

(7) On being informed by Mr Hayat, on 30 November 2015, that Officer Saul had stated that tax losses had been identified in supply chains relating to Indigo and IKB, but that it was unclear whether they related to the PTGI supply chain Mr Ahmed's view (and advice to the Appellant) was that the Appellant need not stop trading with either Indigo or IKB until more was known.

(8) On 2 December 2015 he met with Mr, Mughal to specifically discuss the issue of tax losses. He received assurances from Mr Mughal that there were no changes in IKB's business, and no tax loss letter had been received.

(9) On 4 December 2015 he met Mr Hoque at his business address where he was told that no tax losses had been received by Indigo.

(10) On 10 December 2015, on being informed by the Appellant that it had been formally notified of tax losses, he advised the Appellant to immediately cease trading with Indigo, pending an urgent visit.

(11) He also emailed Mr Hayat on the same day to tell him that, now that the tax letter was specific, another firm should be appointed to conduct urgent due diligence visits on Indigo and IKB. He arranged for Bedrock Tax to be appointed by the Appellant, visit Indigo and IKB and carry due diligence on all supplies.

(12) He also carried out due diligence visits on DMV Communications Limited and Global Routes Ltd and the Appellant, on his advice, did not trade with either.

25. Mr Ahmed was cross examined extensively and our findings on any contentious part of his evidence are set out under the heading 'Findings and discussion' in this judgement.

FINDINGS AND DISCUSSION

26. We have already set out above what we perceive to be the issues in this case. There is no dispute between the parties on the applicable law and there is no controversy as to the approach that we are required to take.

The tax loss, fraud and connection question

27. As we have indicated earlier in this decision the Appellant accepts that the transactions in relation to each of the deal chains is accurate and that there was a tax loss occasioned to the Respondents by virtue of fraud which is connected to the transactions in question. Nevertheless, and in addition we have come to the same conclusion and would have done so without the Appellant's acceptance for the reasons set out in paragraph 12 above.

The knowledge question

28. The Respondents' contentions are twofold. Firstly, they contend that the Appellant knew that the transactions identified earlier in this decision were connected with the fraudulent evasion of VAT. Secondly, and in the alternative, the Respondents assert that the Appellant ought to have known that the transactions were so connected. In support of both contentions the Respondents rely upon the following factors (which are discussed below):

(1) Knowledge of MTIC fraud and contact with HMRC,

(2) Trading patterns and turnover,

(3) Funding of transactions by a third party: Talking Capital,

(4) Dealing with counterparties, and

(5) Due diligence.

Whose knowledge

29. The Respondents submit that, given the Appellant has a legal personality only, we should consider the actual and means of knowledge of the directors of the Appellant and other relevant individuals and impute this to the Appellant. We do not understand the Appellant to be arguing otherwise and this must, in our view, be right in any event.

30. We agree with the Respondents that the relevant individuals for these purposes are Mr Denson, Mr Meloni, Mr Hayat and Ms. Clarke given their witness statements and, in the case of Mr Denson, his oral evidence.

Knowledge of missing trader fraud and contact with HMRC

31. The Respondents assert that the evidence shows that the Appellant had sufficient information to enable it to establish at least the basics of the operation of the fraud and had been on notice that the wholesale airtime sector was particularly affected through its contact with HMRC.

32. The evidence shows that by around 6 May 2014 the Appellant had received a "VAT verification" letter which established that the Appellant's repayment claim for the period ending 31 March 2014 had been selected for verification because there was a risk that it was trading in transaction chains associated with MTIC fraud. Next, a letter is sent by the Respondents to the Appellant on 3 July 2014 providing a VAT fraud alert concerning Alternative Banking Platforms. On 11 August 2014 Mr Saul sent a tax loss letter to Mr Meloni relating to transactions carried out by the Appellant with Parkwell Investment Ltd. A further letter is then sent on by the Respondents to the Appellant on 19 August 2014 containing advice on risks associated with MTIC fraud and the procedures for validating VAT registration details. Importantly, it contains a brief description of how the fraud operates and how it had moved from goods to intangibles and services. Mr Meloni clearly received the letter dated 6 May 2014 as he refers to it in his witness statement. He also says, in his statement, that "*throughout 2014 and 2015, I was involved in communication with HMRC regarding PTGI VAT returns, potential tax losses and the monthly extended verification process… It is, therefore, likely that I had sight of all correspondence to and from HMRC*". It is more likely than not, therefore, that he received the letters dated 3 July 2014 and 19 August 2014.

33. In addition, Mr Meloni spoke to Officer Saul on 8 May 2014 about the extended verification for PTGI's claims, and again on 9 September 2014 (when Officer Saul referred Mr Meloni to Notice 726 with regards to third party payments) and 13 November 2014 (when Officer Saul refused to examine the changed due diligence process beforehand) when they discussed the Appellant's due diligence.

34. In our view this is sufficient to show that by, at least, the end of 2014 Mr Meloni (and therefore by imputation the Appellant) knew the basic operations of MTIC fraud and that the wholesale air time sector (i.e. the sector that the Appellant operated in) was affected by it. To the extent that Mr Denson suggested that this was not the case we reject such evidence.

Trading patterns and turnover

35. The Respondents draw attention to the fact that value of transactions with IKB and Indigo are substantially larger than with those with any other contemporary supplier and that the Appellant's turnover increased significantly as a result. The Appellant does not deny this.

36. The Respondents go on to say that the fact that the Appellant was able to achieve such significant success in its commercial relationships with both Indigo and IKB was something that the Appellant must have known was too good to be true. The Respondents assert that the supplies to IKB and Indigo are anomalous because of their large value when compared with other contemporary suppliers and involve such an increase in percentage terms so as to be inherently implausible.

37. In this case looking at an increase in the ***Appellant's*** turnover (whether in isolation or in conjunction with other factors), in our view, adds very little to the analysis of the Appellant's knowledge or means of knowledge. The key question must be how the increased turnover was achieved. In the present case it is achieved, during the relevant period, largely by reason of the transactions that the Appellant engaged in with IKB and Indigo.

38. Whilst these transactions are acknowledged to be substantially larger, the Appellant says, through Mr Denson, that transactions of this size (including the sudden increase in volume) are not out of the ordinary for the Appellant- a position that Mr Denson maintained during cross examination. He explained that a tier 3 supplier might have access to a good route at a good price for a relatively short period of time during which the volumes transacted with that tier 3 supplier would grow significantly but may drop to next to nothing the following year. Whilst it can, of course, be said that all we have is Mr Denson's word for this and that there is no documentary corroboration we need to weigh this against the evidence (or lack of) to the contrary. Put simply there was no evidence to the contrary on this issue for us to examine. None of the Respondents' witnesses could help us with what "normal" transactions in the industry might look like and Mr Saul accepted during cross examination that the volumes supplied to the Appellant by IKB and Indigo can occur in legitimate deals.

Funding of transactions by a third party: Talking Capital

39. It is not in dispute that the Appellant was asked to enter into a factoring arrangement by IKB and/or Indigo with Talking Capital and did so in relation to both suppliers.

40. The Respondents' position is that encouragement by a supplier to use an alternative banking platform overseas would have been an obvious indicator that the transactions were part of a fraudulent scheme. One of the questions that traders are asked to ask themselves in Notice 726 is "*Does your supplier (or another business in the transaction chain) require you to make third party payments or payments to an offshore bank account?*". They argue that the factoring arrangement that the Appellant entered into with Talking Capital was a clear indicator of fraud in the context where:

> (1) The Appellant had not used the services of a factoring company prior to the transactions in question;
>
> (2) The policy operated by the Appellant prior to these transactions was that it would pay only the entity with whom it had signed the contract and done business with and pay only into an account in the jurisdiction in which the supplier was based;
>
> (3) There is no explanation why the above policy was put to one side when it came to IKB and Indigo;
>
> (4) No explanation is provided as to how Indigo came to enjoy an arrangement with Talking Capital;
>
> (5) The Appellant was provided with a draft agreement by Talking Capital which referred to Manhattan Systems Ltd as a party in the circumstances where the Appellant had received a tax loss dated 10 September 2013 (i.e. some 16 months earlier) setting out that supplies that it had received from Manhattan Systems Ltd traced back to tax losses. Therefore, Mr Denson was on notice that Talking Capital had factored deals conducted by a supplier whose supplies had been found to trace to tax losses;
>
> (6) The Appellant, through Mr Denson, whilst appreciating the significance of the factoring arrangement as an indicator of fraud chose to seek to change the arrangements

so as to "*remove the view of the HMRC seeing the flow of cash from a USA entity"*, in other words to cover it up, rather than consider it worthy of further enquiry;

(7) There were no commercial checks conducted by the Appellant on Talking Capital; and

(8) It was clear that neither IKB nor Indigo could transact at those levels without a funding arrangement of this sort.

41. The Appellant put forward, through Mr Denson, evidence that whilst the Appellant had not hitherto engaged in any factoring transactions Mr Denson had done so at other companies. He thought that factoring arrangements were a normal part of conducting business and agreed that it was only through such an arrangement that Indigo or IKB could conduct the volume of trade that they did. Mr Denson denied putting aside the Appellant's policy with regards to payments to third parties, but it is clear to us that exceptions were made when it came to Indigo and IKB. The starkest of which was the decision to enter into the factoring arrangement itself which necessitated the wholesale revision of the contractual relationship between the Appellant and IKB and the Appellant and Indigo. During cross-examination Mr Denson said that he could not now recall whether or not he had made the connection with Manhattan Systems Ltd and trade losses but said that Talking Capital had been properly vetted and commercial checks had been conducted. He did not know how Indigo came to be put in touch with Talking Capital and strenuously denied that he had tried to cover anything up or hide anything from the Respondents.

42. In essence, the Respondents are saying that the factoring arrangement represented a payment to a third party using an offshore account and an alternative banking platform and this in the context where the transaction was wholly irregular given the Appellant's previous trading meant that this was a clear indicator of fraud which the Appellant ought to have, at the very least, further investigated, but chose instead to, effectively, *cover it up*.

43. The term "alternative banking platform" in the context used by the Respondents in this case was defined in a letter sent to the Appellant on or around 3 July 2014 as "*a kind of virtual financial institution that provides the functionality of a traditional bank's reporting or regulatory requirements*". Neither the arrangement nor any of the parties to the factoring arrangements concerning this appeal answer, on the evidence before us, to that description.

44. The submission that the Appellant sought to change the factoring arrangements so as to cover this aspect, or part of it, up is made because of an unfortunate remark made by Mr Denson in his email to Rodney Omanoff of Talking Capital dated 3 June 2015. The context in which the remark is made is, in our view, important. The email reads:

> "Following up on our meeting with our outside legal firm on VAT here in the UK. CTM is the firm we use in the UK…
>
> Our VAT legal due diligence firm has recommended that the funding of the supplier be changed so as to avoid possible issue (due to lack of knowledge and undertaking) with the HMRC tax investigators. CTM feel that the HMRC will see funding by a UUSA [sic] firm and immediately a red flag will go up and the notion of fraud will be in question, clearly we all want to avoid this thinking at the HMRC as we operate and work in a very legal and ethical manner and do not need this type of noise. Below I have outlined the current and proposed flow moving forward…

> Basically, the new process will remove the view of the HMRC seeing the flow of cash from a USA entity and will see the funds be send [sic] daily from the customer (PTGI-ICS) to thee [sic] supplier in the UK."

45. In our judgment this email, when read as a whole, can best be described as a decision by the Appellant to rearrange the factoring arrangement so as to avoid the Respondent thinking that the Appellant's business presented a higher risk where this particular type of fraud was concerned and the additional scrutiny or "noise" that this would have entailed.

46. In summary, there can be no doubt that the arrangement involved payment being routed through a third party via one or more offshore bank accounts. It is also clear that the Appellant had never, hitherto, entered into any form of factoring arrangement with one of its suppliers and that this was for it, at the time, something outside of the ordinary course of its business. It is also more likely than not that the Appellant (by virtue of the knowledge of Mr Denson and/or other key employees) appreciated that Manhattan Systems Ltd was likely to have been a previous client of Talking Capital and that the former had been connected to a tax loss by the Respondents. Further, the Appellant attempted to restructure the factoring arrangement and in this context, it is fair to say that one of the motives for doing so was to avoid additional scrutiny from the Respondents. However, taken as a whole, none of this amounts to obvious indicators that the transactions were connected with a fraudulent scheme. The best that can, fairly, be said is that these matters ought to have put the Appellant on heightened alert.

Dealings with IKB and Indigo

47. The Respondents argue that an analysis of the Appellant's dealings with IKB and Indigo compounds the inference that the Appellant knew that its transactions were fraudulent or at the very least ought to have known.

48. The Respondents submit that (i) the Appellant offered to IKB and Indigo for signature carrier agreements before it had received any due diligence information, (ii) there is a lack of clarity about how the Appellant came to know of Indigo and (iii) there is no record of price negotiations or discussions of day-to-day operations.

49. There is no denying (and the Appellant does not seek to do so) that the Appellant offered carrier agreements for signature to both IKB and Indigo before the due diligence information was received. However, Mr Denson put this down to an eagerness by the sales team to secure a sale. He points out, and we accept, that no transactions were conducted before the receipt of the due diligence information. He also explained the dynamic nature of the business and that it was likely that much of the discussions around price were carried out over the telephone or on whatsapp and it was not common practice for such 'meetings' to be formally noted. He also pointed to the significant time that had elapsed. These explanations ring true and we accept them.

Due diligence

50. Under this heading the Respondents start by submitting that the Appellant was well aware of the need to conduct due diligence and was further aware that it was for the Appellant to establish the integrity of its trading partners and the integrity of its transactions. If what is meant by this submission is that it was for the Appellant to satisfy itself that the transactions it engaged in were not connected with fraud and that conducting proper due diligence on trading partners was a means by which the Appellant could be so satisfied and that the Appellant knew and had been told that this was the case then we have little hesitation in concluding, on the evidence, that this was the case.

51. The Respondents then went to some significant lengths to criticise the due diligence conducted by the Appellant and by Mr Ahmed on Indigo and IKB.

52. Our conclusion on the due diligence carried out on Indigo and IKB by the Appellant in house is that it was lacking. For example, a reference about IKB from Indigo indicated that the two had been in a commercial relationship since 2013 when the true position was that Indigo could not have conducted business until July 2014 at the earliest. A rudimentary cross check would have highlighted this issue. Another example is a failure by the Appellant to seek company accounts from Indigo. This resulted in a missed opportunity to identify the false reference provided by IKB and to identify that Indigo had not long been in business.

53. The due diligence carried out by Mr Ahmed (and CTM) on Indigo and IKB was, in our view, undertaken late (with the results only being reported to the Appellant on 9 July 2015 when over half of the deals under appeal had been concluded), carried out in circumstances where there was a clear prospect of a conflict of interest given Mr Ahmed's previous dealings with IKB and lacking in that Mr Ahmed placed an over-reliance on the self-serving and self-reported information provided to him by the directors of IKB and Indigo. The latter cannot be explained away by Mr Ahmed saying that he thought that it was for the Appellant to carry out further checks on the information provided by the directors of IKB and Indigo. In our view Mr Ahmed's role cannot be restricted to that of a mere conduit passing, unadulterated, the information that he has obtained. If his reports or opinions are to be worth anything to the Appellant then he must, at the very least, apply a critical eye to the information that he has been provided with.

54. The due diligence carried out by the Appellant on Indigo and IKB (whether by itself or through Mr Ahmed) in totality is, therefore, clearly lacking. However, it must be remembered that we are looking at the position with the benefit of twenty-twenty hindsight. Further, we accept that the relevant due diligence was being carried out during the chaos of a restructuring exercise which, ultimately, involved the Appellant's business ceasing.

55. To the extent that the Respondents contend that the due diligence that was conducted was conducted not in order to protect the Appellant from entering into transactions connected with fraud, but to give the appearance of thorough enquiry we find this to be unsupported by the evidence. In reality, it is more likely than not that, the due diligence was carried out both to protect the Appellant from entering into transactions connected with fraud and to give the appearance of thorough enquiry. The former to prevent the worst from happening and the latter to provide a means of escape if the worst should happen.

Conclusions on knowledge

56. It must, of course, be right to say that a fraudster is unlikely to leave direct evidence as to his state of knowledge behind and, therefore, the Respondents must almost always rely upon inference and indirect evidence. Nevertheless, the burden of proof remains with the Respondents and this tribunal can only make a decision based upon the evidence. The Respondents, essentially, rely upon the factors identified above to urge us to conclude that the Appellant knew or should have known that the transactions were connected with fraud.

57. We remind ourselves that it is not sufficient for us to conclude that the Appellant might have known that the relevant transactions were more likely than not connected with fraudulent evasion. What must be established, on the balance of probabilities, is that the Appellant should have known or should have known that the only reasonable explanation for the circumstances in which the relevant purchases took place was that they were transactions connected with such fraudulent evasion.

58. It seems to us to be clear, from what we have said above and based upon the evidence before us, that the Appellant knew that there was a problem with MTIC VAT fraud in the sector that it operated in and, further, knew of the basics of this type of fraud.

59. It is also relatively clear that the value of transactions between the Appellant and IKB and the Appellant and Indigo were significantly larger when compared against other contemporary suppliers. Mr Denson's evidence and explanation was that this came as no surprise to him and there were other niche suppliers where the business that the Appellant was putting to them caused significant increases in turnover. Whilst there was no documentary evidence to corroborate this, Mr Denson's testimony, which remained on this point intact during cross-examination, was the only evidence available to us (on this point). There was no evidence as to industry norms against which we could judge what Mr Denson had told us and thus we are led, inevitably, to the acceptance of Mr Denson's evidence on this point.

60. We have concluded that the factoring arrangement ought to have put the Appellant on heightened alert because the arrangement involved paying a third party via an offshore bank account in circumstances where this was a novel arrangement for the Appellant at the time and one of the parties (Talking Capital) appeared to have conducted business with Manhattan Systems Ltd, a company whom the Appellant was or ought to have been aware the Respondent had connected to tax losses.

61. Lastly, we have come to the conclusion that the due diligence carried out by the Appellant on IKB and Indigo was lacking. The Respondents assert that because the due diligence was insufficient it did not provide the Appellant with the means to make an informed decision as to whether to trade with IKB or Indigo. The proper question for us to ask ourselves is not "*Did the Appellant carry out proper due diligence?*"; but "*Did the Appellant have the means at its disposal of knowing that by its purchases it is participating in transactions connected with fraudulent evasion of VAT?*" Proper due diligence might be part of the means available to the Appellant. It is not the only means and that is why Moses LJ in ***Moblix*** encouraged the courts not to ***unduly*** focus on the question of whether the Appellant has acted with due diligence. It is right that in the context of due diligence, contrary to the submissions made on behalf of the Respondents, we should take into account the success or otherwise of the Respondents in understanding the fraud risk posed by IKB and Indigo in the deal chain. This is because we not only have to answer the subjective question as to whether the Appellant knew but also the objective question of whether the Appellant should have known. The latter must involve holding the Appellant to some sort of objective standard. When answering the latter question it is appropriate, in our view, to take into account what the Respondents were able to establish in their "due diligence" of IKB and Indigo. It is telling, though far from conclusive, that despite the Respondents carrying out regular monitoring visits and seeking (and obtaining) large amounts of information from IKB and Indigo, neither were deregistered for VAT for abusive behaviour or had input VAT claims denied during the relevant VAT periods. It is difficult to see how the means of knowing available to the Appellant can be said to be better than those available to the Respondents. It is fair to say that the Appellant could have asked more questions and been more thorough in the due diligence it carried out or had carried out on its behalf. However, even if the due diligence carried out was materially better (but not perfect) it is unlikely that this would have given the Appellant the means of knowing that the transactions were connected with fraud.

62. These factors, either alone or taken together, do not establish on the balance of probabilities that the Appellant knew that the relevant transactions were connected to fraud. We have dealt with, above, the issues surrounding corporate knowledge and indicated that we

would be looking at the knowledge of Mr Denson, Mr Meloni, Mr Hayat and Ms. Clarke. The evidence does not show that these individuals (either alone or together) knew that the relevant transactions were connected with fraud.

63. The more difficult question to answer is whether the Appellant should have known from the surrounding circumstances that the transactions were connected with fraud. This also includes the situation where the Appellant should have known that the only reasonable explanation for the transaction was its connection with fraud. The relevant surrounding circumstances here, including the factors set out above, do not establish that the Appellant should have known of the connection to fraud and nor should they have known that the only reasonable explanation was a connection with fraud. The surrounding circumstances establish, in our view, a heightened risk that transacting with IKB and Indigo might result in a connection with fraud and no more. Those circumstances, when viewed in light of the explanations and evidence provided by the Appellant, do not lead us to the conclusion that the Appellant ought to have known that the relevant transactions were connected with fraud or that the only reasonable explanation was that they were so connected.

CONCLUSIONS

64. For the reasons set out above we allow this appeal.

65. We should like to take this opportunity to publicly acknowledge the work done by Ms. Robinson, Ms. Udom, Mr Bedenham and their respective teams in marshalling and then presenting the voluminous material in this lengthy hearing before us. In particular, we are indebted to counsel for their very helpful skeleton arguments and written submissions which have made the task of writing this judgment that much easier. We should also like to thank all the participants for their patience during the various technological difficulties that we experienced in this hearing.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

66. 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.

ASIF MALEK
TRIBUNAL JUDGE

Release date: 10 JANUARY 2022

APPENDIX 1: THE LAW

Statute & Statutory Instruments

Articles 167 and 168 of Council Directive 2006/112/EC provide:

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

Council Directive 2006/112/EC is given effect in domestic law by the Value Added Tax Act 1994 ("VATA") and regulations made under it.

The relevant provisions concerning the right of a registered person to deduct input tax from output tax and to be paid or reimbursed the difference are Ss. 24, 25 & 26 VATA and Regulation 29 of the VAT Regulations 1995:

> ***"24 Input tax and output tax.***
>
> *(1)Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—*
>
> *(a) VAT on the supply to him of any goods or services;*
>
> *(b) VAT on the acquisition by him from another member State of any goods; and*
>
> *(c) VAT paid or payable by him on the importation of any goods from a place outside the member States, being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.*
>
> *…*
>
> *(6) Regulations may provide—*
>
> *(a) for VAT on the supply of goods or services to a taxable person, VAT on the acquisition of goods by a taxable person from other member States and VAT paid or payable by a taxable person on the importation of goods from places outside the member States to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such*

documents as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases;

25 Payment by reference to accounting periods and credit for input tax against output tax.

(1) A taxable person shall—
(a) in respect of supplies made by him, and

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

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

26 Input tax allowable under section 25.

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

(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;

(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection…."

"Claims for input tax

Reg 29. *—*

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

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

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

European Caselaw:

The right to refuse repayment of input tax arises from a series of decisions of the ECJ.

In *Halifax plc v Customs and Excise Commissioners* (Case C-255/02) [2006] STC 919 the Court of Justice found that where tax is evaded by the taxable person himself the criteria of supplies and economic activity will not be met and, accordingly, there would not be a right to deduct input tax in relation to the transactions concerned ("the Halifax Principle.")

In *Optigen Ltd v Commissioners for Customs and Excise* [2006] Ch 218 @ 47 & 51-52 ("*Optigen*") it was held that transactions, not themselves vitiated by VAT fraud, did meet the criteria of supplies and economic activity regardless of the possible fraudulent nature of another transaction, prior or subsequent, in the supply chain of which the taxable person had no knowledge and no means of knowledge and, accordingly, there would be a right to deduct input tax in relation to the transactions concerned ("the Optigen Principle.")

In *Axel-Kittel v Belgium; Belgium v Recolta Recycling* [2006] ECR 1-6161; [2008] STC 1537 @ 51-61 ("*Kittel"*) the Court of Justice considered the middle ground between the Halifax Principle and the Optigen Principle; being the situation where the taxpayer himself was not seeking to evade tax, but did have knowledge or means of knowledge of a fraud by someone else. The Court of Justice said:

"…56 In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

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

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

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

In summary, the Court of Justice held that where, having regard to objective factors, the taxable person knew or should have known that he was participating in a transaction connected with the fraudulent evasion of VAT there would not be a right to deduct input tax in relation to the

transactions concerned even where the criteria of supplies and economic activity were met ("the Kittel principle.")

English Caselaw

The Kittel principle has been discussed in a number of English authorities and, in particular, consideration has been given to the knowledge or means of knowledge test.

In *Megtian Limited (In Administration) v the Commissioners for Her Majesty's Revenue and* Customs [2010] EWHC 18 (Ch) @ paras 33 – 38 Mr Justice Briggs clarified the decision of Lewison J in *HMRC v Livewire and Olympia* [2009] EWHC 15 02 – 106 ("*Livewire*") and stated that it is not necessary to demonstrate knowledge or means of knowledge of the detail of the fraud:

> *"33. Mr Patchett-Joyce's submission under Ground 3 was that, in the light of Livewire, it was necessary in any case where a disallowance of input tax was to be made good as against the broker at the foot of the clean chain in a contra-trading case to demonstrate, and for the Tribunal on appeal to find, that the broker knew or ought to have known specifically of one or other of those two aspects of the underlying fraud….*
>
> *34. I disagree. I do not read Lewison J's analysis of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known.*
>
> *35. In the first place, Lewison J was, as he made very clear, addressing the question what had to be demonstrated against an honest broker who was not a dishonest co-conspirator in the tax fraud. In the present case, the Tribunal's conclusion, after hearing oral evidence from and cross-examination of Mr Andreou, Megtian's shareholder and principal manager, was that Megtian knew that the transactions on which it based its claim were connected with fraud: see paragraph 112 of the Decision. Participation in a transaction which the broker knows is connected with a tax fraud is a dishonest participation in that fraud: see below.*
>
> *36. Secondly, Lewison J acknowledged that in many if not most cases of contra-trading, the clean chain and the dirty chain were likely to be part of a single overall scheme to defraud the Revenue. As he put it, at paragraph 109: "Indeed it seems to me that the whole concept of contra-trading (which is HMRC's own coinage) necessarily assumes that to be so."*
>
> *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."

Arden LJ confirmed this in Fonecomp Ltd v The Commissioners for Her Majesty's Reevenue & Customs [2015] EWCA Civ 39 @ paragraphs 45 -52.

Red 12 Trading Ltd v The Commissioners for Her Majesty's Revenue and Customs [2009] EWHC 2563 (Ch) at paras 109 – 111 ("*Red 12*") stated that:

(3) "… 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."

The Court of Appeal in *Mobilix Ltd (In Administration) v HMRC; HMRC v Blue Sphere Global Ltd,; Calltel Telecom Ltd and another v HMRC [2010] EWCA Civ 517* ("Mobilix") considered the question of knowledge and held 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.
61. Such an approach does not infringe the principle of legal certainty. It is difficult to see how an argument to the contrary can be mounted in the light of the decision of the court in Kittel. The route it adopted was designed to avoid any such infringement. A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not

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

62 The principle of legal certainty provides no warrant for restricting the connection, which must be established, to a fraudulent evasion which immediately precedes a trader's purchase. If the circumstances of that purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that that evasion precedes or follows that purchase. That trader's knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs."

In *AC (Wholesale) Ltd v The Commissioners for Her Majesty's Revenue & Customs [2017] UKUT 191 (TCC)* @ paragraph 27 the Upper Tribunal ("UT") stated that "…the 'only reasonable explanation' test is simply one way of showing that a person should have known that transactions were connected to fraud." The Upper Tribunal went on to state that:

"29 It is, to us, inconceivable that Moses LJ's example of an application of part of that test, the 'no other reasonable explanation', would lead to the test becoming more complicated and more difficult to apply in practice. That, in our view, would be the consequence of applying the interpretation urged upon us by Mr Brown. In effect, HMRC would be required to devote time and resources to considering what possible reasonable explanations, other than a connection with fraud, might be put forward by an appellant and then adduce evidence and argument to counter them even where the appellant has not sought to rely on such explanations. That would be an unreasonable and unjustified evidential burden on HMRC. Accordingly, we do not consider that HMRC are required to eliminate all possible reasonable explanations other than fraud before the FTT is entitled to conclude that the appellant should have known that the transactions were connected to fraud.

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."

APPENDIX 2: THE DEALS