[2016] UKUT 274 (TCC)

Appeal ref: UT/2015/0049

VAT – MTIC – transactions connected with fraud – transactions effected by agent – agent knew or ought to have known that transactions were connected with fraud – whether knowledge of agent to be attributed to principal - preliminary issue on assumed facts

IN THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)
ON APPEAL FROM THE FIRST-TIER TRIBUNAL
(TAX CHAMBER)

Between:

MOBILE SOURCING LIMITED

Appellant

- AND -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: MR JUSTICE MORGAN AND JUDGE GREG SINFIELD

Sitting in public at Royal Courts of Justice, Rolls Building, Fetter Lane, London, EC4A 1NL on 25 and 26 April 2016

Mr Geoffrey Cox QC (instructed by The Khan Partnership LLP) for the Appellant
Mr Michael Holland QC, Mr Christopher Foulkes and Mr Jamie Sharma (instructed by General Counsel and Solicitor for HM Revenue and Customs) for the Respondents

DECISION

RELEASE DATE: 17 June 2016

Tribunal Judges: Mr Justice Morgan and Judge Greg Sinfield:

Introduction

1. This is an appeal by Mobile Sourcing Ltd ("MSL") against the decision of the First-tier Tribunal (Judge Rachel Short) ("the FtT"), released on 8 December 2014. The FtT determined a preliminary issue arising in this case. The FtT decided that issue in favour of Her Majesty's Revenue and Customs ("HMRC") and MSL now appeals with the permission of Judge Greg Sinfield, given on 15 April 2015. The FtT's determination was on the basis of assumed facts. In our decision we also will proceed on the basis of assumed facts. Unfortunately, there is now a dispute as to precisely what facts should be assumed.

2. In April 2006, MSL, acting through its agent Wigig.com Ltd ("Wigig"), engaged in transactions which involved the purchase and re-sale of mobile telephones. Those transactions were connected with fraud. The fraud was of the usual MTIC variety, a type of fraud which has been described in many earlier decisions of First-tier Tribunals and Upper Tribunals and which we need not describe again.

3. MSL has applied to HMRC to deduct input value added tax which it paid in connection with these transactions. HMRC have denied MSL's entitlement to deduct input tax on the ground that MSL knew or should have known that it was participating in a transaction connected with the fraudulent evasion of VAT. For this purpose, HMRC relies upon the statements of principle laid down by the Court of Justice in Axel Kittel v Belgium, Belgium v Recolta Recycling Joined Cases C-439/04 and C-440/04 [2006] ECR 1-6161 (hereafter "Kittel"). Those principles have consistently been followed in later decisions of the Court of Justice and they are helpfully discussed by the Court of Appeal in Mobilx Ltd v HMRC [2010] EWCA Civ 517.

4. MSL accepts that Wigig knew or should have known that the relevant transactions were connected with fraud. However, MSL contends that it did not itself know, nor should it have known, those matters. HMRC submits that even if MSL were able to prove that it did not itself know or should have known those matters, Wigig's knowledge was to be attributed to MSL so that, in law, the position is taken to be that MSL did know or should have known that the transactions were connected with fraud. MSL submits, in response, that on the assumed facts of this case, the state of mind of Wigig was not to be attributed to MSL.

5. The parties agreed that instead of there being a lengthy hearing when all matters of fact would be explored and then determined, the FtT should be asked to determine the issues arising as to attribution on the basis of assumed facts. It was explained to us that both parties considered there were advantages

to proceeding in that way. HMRC considered that if MSL were allowed to put forward its version of the assumed facts and if it failed on those assumed facts, then realistically that would be the end of MSL's appeal. Similarly, MSL considered that if it identified assumed facts but the FtT held that even on those assumed facts Wigig's state of mind was to be attributed to MSL, then MSL would save itself the time and expense involved in attempting to prove those assumed facts. Conversely, if the FtT were prepared to find in favour of MSL on the assumed facts, it would be worth MSL's while to have a hearing at which it would attempt to prove those facts.

6. Before the FtT, the parties submitted that the issue as to attribution of Wigig's state of mind to MSL was to be decided by reference to the principles identified by the Upper Tribunal in Greener Solutions v Revenue and Customs Commissioners [2012] UKUT 18 (TCC) (hereafter "Greener Solutions"). In its Decision, the FtT applied those principles and found against MSL.

7. Since the Decision of the FtT, the Supreme Court has decided Bilta (UK) Ltd v Nazir (No. 2) [2016] AC 1 (hereafter "Bilta") and we will apply the principles in Bilta to the relevant facts in reaching our Decision on this appeal.

The facts

8. For the purpose of identifying the facts which are to be assumed for the purpose of deciding the preliminary issue as to attribution, it is necessary to describe some of the procedural history of this case.

9. MSL's appeal to the FtT appears to have been brought in around 2006. Over the years, there has been a series of adjournments of the intended hearing of that appeal. On 31 January 2014, MSL amended its Grounds of Appeal to the FtT and specifically contended that to the extent that HMRC would rely on the knowledge of Wigig to demonstrate that MSL knew or should have known that the relevant transactions were connected with fraud, such knowledge could not be attributed to MSL because Wigig knew or believed that its actions were detrimental to the interests of MSL in a material respect, such that "the fraud exception" (which we refer to below) should apply to prevent attribution of Wigig's knowledge to MSL for the purposes of its claim to deduct input tax.

10. Following a hearing on 26 March 2014, the FtT (Judge Barbara Mosedale) directed that there should be a hearing of a preliminary issue on the question of attribution. The FtT directed that MSL should serve on HMRC a statement of the issues for determination and such statement should set out the facts which MSL would say that the FtT was to assume for that purpose. The FtT then directed that HMRC was to respond to this statement and seek to agree the preliminary issue or issues. The FtT's directions stated that it would not resolve factual issues and that no evidence was to be relied upon at the hearing of the preliminary issues.

11. On 16 June 2014, MSL served its statement of the proposed preliminary issues. That statement identified the facts which MSL said should be assumed for the purpose of deciding those issues. On 30 June 2014, HMRC served its

response stating that the facts to be assumed for the purpose of the preliminary issues were for MSL to identify; HMRC also identified its draft issues. On 25 September 2014, MSL responded with a different draft of the issues.

12. In its Decision, the FtT set out what it said were "the assumed set of facts provided by" MSL. It was not argued before us that the facts provided by MSL were not accurately set out by the FtT and we will adopt those facts for the purposes of our Decision.

13. The assumed facts as set out by the FtT at [6] were as follows:

> "The parties agreed at the Tribunal that the assumed set of facts provided by the Appellant should form the basis of the Tribunal's decision;
>
> (1) There was an agreement between MSL and independent third party entity Wigig whereby Wigig would carry out trades as agent for MSL using MSL's working capital in consideration for which Wigig would receive 50% of gross profits on each transaction as commission. (the "MSL Trades")
>
> (2) MSL was not directly involved in carrying out the relevant transactions or the due diligence checks which were carried out on its behalf by Wigig.
>
> (3) From early 2005 there was a further agreement with Wigig whereby MSL advanced funds to Wigig to allow it to trade on its own account and in its own name. In consideration for providing loan finance MSL was to receive 50% of the profit generated by trades carried out using its funds (the 'Wigig Trades').
>
> (4) It was a term of the loan agreement that funds loaned to Wigig were for the sole purpose of allowing it to fund its own transactions and in particular the VAT 'lock up' on those transactions.
>
> (5) It was a further term of the loan agreement that Wigig Trades would not involve giving or receiving trade credit so as not to put the loan balance at risk.
>
> (6) MSL relied upon the assurances of the officers and employees of Wigig and in particular its director Richard Jones that (a) transactions were carried out conscientiously and properly with neither the knowledge nor the means of knowledge of the alleged connection to missing traders and (b) the terms of their agreement were being observed.
>
> (7) Funds that were removed from or repaid to MSL's bank account to finance Wigig Trades were recorded in a loan account, the balance of which at any time represented the

amount owed by Wigig in respect of funds loaned to finance its own trading.

(8) Wigig was given access and was a signatory to MSL's bank account and was responsible for dealing with money transfers.

(9) Wigig ceased trading in May 2006 and administrators were appointed in October 2009. Wigig had debtors in excess of £6m and trade creditors in excess of £7m. The final balance of the MSL loan account as at 15 May 2006 was in excess of £3m and this sum remains outstanding to MSL.

(10) Following receipt of a letter dated 6 April 2006 from HMRC informing Wigig that they would be withholding their February 2006 VAT reclaim, (relating to Wigig Trades) Wigig carried out no trades using MSL's funds until 28 April 2006 when it carried out trades on which the VAT "lock up" was in excess of £500 thousand.

(11) In April and May 2006 Wigig withdrew in excess of £1m from MSL's bank account which it used to fund trades on 28 April 2006.

(12) Had the trades on 28 April 2006 not been carried out and had the funds in excess of £1m not been withdrawn from MSL's bank account, the balance of MSL's loan would have been no higher the £2.2m rather than the final outstanding balance in excess of £3m.

(13) Wigig had received stock from its suppliers in respect of the May 2006 purchases before making payment and had released stock before receiving payment.

(14) Following receipt of the letter dated 6 April 2006 from HMRC, Wigig withdrew from its own bank account almost £400 thousand and distributed the same to its shareholders as dividends.

(15) On 27 September 2012 Richard Jones gave a director's disqualification undertaking in respect of Gold Digit Limited (an unrelated company) on the ground that he had conducted multiple transactions in respect of which he knew or possessed the means to know of their connection to fraud. Those transactions were carried out over a period that included the dates of the transactions which are the subject matter of this appeal."

14. This statement of the assumed facts did not in terms deal with the knowledge of Wigig in all relevant respects. However, the FtT stated at [2]:

> "MSL appointed a third-party agent, Wigig to carry out due diligence and make trading decisions on its behalf including for the transactions to which the disallowed input tax relates ('the Disputed VAT Trades'). It is not disputed that Wigig was properly appointed as MSL's agent and that MSL is therefore liable for Wigig's actions and imputed with Wigig's knowledge. It is not disputed that Wigig knew or should have known that the Disputed VAT Trades for the 04/06 periods were connected with fraud."

15. In the course of summarising the submissions made to it by counsel for MSL and for HMRC, the FtT referred to other matters which were contended for by MSL which were not necessarily within the assumed facts which MSL had earlier put forward. Perhaps in response to that, the FtT said at [30]:

> "Both parties stressed the need to ensure that the Tribunal came to its decision on the basis of the assumed facts only and not any further extrapolation from those assumed facts. In coming to its decision the Tribunal has relied in particular on the following facts:
>
> (1) The deals which are disputed by HMRC and for which input tax has been denied are MSL Deals for the 04/06 period which were carried out in MSL's name by Wigig on 28 April 2006. The input tax reclaim is in MSL's name. They are not deals for which funding provided through the MSL account to Wigig was required.
>
> (2) The alleged fraudulent actions of Wigig in respect of the MSL bank account, being (a) the failure to notify MSL of HMRC's letter 6 April 2006 (b) the withdrawal of significant sums in April and May 2006 from MSL's bank account to fund trades (c) the payment of large sums by way of dividends to Wigig's shareholders as dividends and (d) the creation of unauthorised debtors and creditors, all relate to Wigig's loan agreement with MSL concerning the funding of Wigig Trades."

16. Although the FtT had given MSL a free hand when identifying the facts which MSL wanted the FtT to assume for the purpose of the preliminary issues and although MSL had drafted its version of the assumed facts, it seems that MSL has throughout been referring to and relying on alleged matters of fact which were not stated in its draft of the assumed facts. For example:

(1) in his submissions to the FtT, Mr Cox QC, leading counsel for MSL, referred to matters of alleged facts which were not in MSL's draft of the assumed facts;

(2) in its Grounds for Permission to Appeal which were presented to the FtT after the FtT Decision, MSL suggested that the FtT was wrong in law in failing to draw inferences of fact from the assumed facts;

(3) in its subsequent application to the Upper Tribunal for permission to appeal and in its skeleton argument on this appeal, MSL again contended that the FtT should have drawn inferences of fact from the assumed facts.

17. In their response to MSL's suggestion that further facts should be inferred from the assumed facts, HMRC contended that if MSL had wanted the FtT to proceed on the basis of further facts, it should have expressly included those facts in its draft of the assumed facts. HMRC further submitted that on this appeal to the Upper Tribunal, MSL could not successfully argue that the FtT was wrong to decline to draw further inferences from the assumed facts unless it could show that the FtT was wrong in law in that respect and that would require the Upper Tribunal to find that the FtT's decision not to infer further facts was perverse.

18. At the hearing, our reaction to these submissions was that there was considerable force in HMRC's contention that MSL should not be relying on inference at all; if it had wanted the FtT to proceed on the basis of a particular fact it should have expressly included that fact in its draft of the assumed facts. Further, in so far as the FtT had been prepared to draw inferences but had declined to draw specific inferences contended for by MSL, then the Upper Tribunal could only reach a different conclusion from that of the FtT if the FtT had committed an error of law.

19. At the hearing, we raised with counsel for both parties the question as to what the situation would be if we declined to infer the matters which MSL contended should be inferred and we then decided the appeal on the basis of the facts assumed or found by the FtT. Would it then be open to MSL to contend that its full appeal to the FtT should proceed to a hearing before the FtT at which hearing MSL would be free to lead evidence to establish such facts as it could, and to contend on the basis of such facts that other facts were to be inferred, so that the FtT would make its ultimate decision having considered those matters? Such a course would seem to be wholly inconsistent with the original intention which was that MSL should put forward the facts which it said it would set out to establish (whether by proof or by inference) and that the parties would argue the preliminary issues on that basis. Conversely, it should be noted that when the FtT ordered that there be preliminary issues, it did not, in terms, order that if MSL lost the preliminary issues, then its appeal to the FtT would be dismissed.

20. We considered that MSL was largely responsible for the difficulties it had got itself into in relation to the facts to be assumed for the purposes of the preliminary issues. However, we were concerned that if we dismissed the appeal to the Upper Tribunal on the basis of our reading of MSL's draft of the assumed facts, the matter might not be concluded and a fact finding hearing might have to be held. We therefore asked Mr Cox QC, leading counsel for MSL, to set out expressly the facts which he wished to contend should be taken into account for the purpose of deciding the appeal to the Upper Tribunal against the FtT's decision on the preliminary issue.

21. Mr Cox considered the matter overnight and produced a note setting out the facts which he said we should take into account. For that purpose, he referred to facts which were expressly included in MSL's draft of the assumed facts and matters put in argument to the FtT at the hearing before the FtT and, indeed, further matters. We will now set out the relevant facts set out in Mr Cox's note (without the cross-references he gave us):

> "***The fraud on MSL***
>
> 1. The sum of £1,010,000 was withdrawn by Wigig's operators from MSL's bank account in April and May 2006.
>
> 2. At this time, the directors and shareholder of Wigig paid themselves a purported dividend of £400,000 when the company was insolvent. It ceased trading in May owing £7 million with trade debtors of £6 million. According to the agreement between MSL and Wigig, there should have been no means by which Wigig should have been insolvent.
>
> 3. On 6 April 2006, Wigig had been informed that they would not receive VAT repayments from their February trades because they would be subjected to extended verification. From that point, Wigig knew that it was unlikely that they would be able to reclaim successfully on *any* further trades, whether in the name of Wigig or MSL.
>
> 4. Access by Wigig to the MSL bank account had to be justified by evidence of trading from Wigig's operators. They carried out the disputed MSL trades on 28 April and further Wigig trades in early May.
>
> 5. Therefore, it is reasonable to suppose that the trades on 28 April in the name of MSL, and later in early May by Wigig, were principally intended as a pretext for the real objective of raiding the Appellant's bank account."

22. We have now set out the widest statement of all of the facts which MSL might be able to contend for as facts to be assumed for the purpose of deciding the preliminary issues.

The earlier authorities

23. As we will explain later in this Decision, the legal principles which we will apply in this case have developed somewhat from the statement of the principles which the FtT was asked to apply. However, in order to understand the decision of the FtT and the grounds of appeal which have been put forward, we will summarise the legal principles on which the FtT was asked to reach its decision. The FtT relied on the decision of the Upper Tribunal in Greener Solutions which was itself based on the decision in McNicholas

Construction Co Ltd v Customs and Excise Commissioners [2000] STC 553 ("McNicholas").

24. In McNicholas, the company had submitted VAT returns in which it claimed to deduct input tax which it had paid in respect of alleged transactions which had not genuinely occurred. The company's site managers knew that the alleged transactions had not taken place. Section 60 of the Value Added Tax Act 1994 had the effect that the company was liable to a penalty if it had done any act for the purpose of evading VAT or its conduct involved dishonesty.

25. The question arose as to whether the dishonest acts and intentions of the site managers should be attributed to the company. The judge (Dyson J) held that those acts and intentions should be attributed to the company. Even though such attribution did not result from the primary rules of attribution or the general rules of agency or the ordinary rules as to vicarious liability, it was appropriate in the relevant statutory context to attribute to the company the acts and knowledge of the persons who had a part to play in the making and receiving of the supplies involved in the VAT arrangements. This was appropriate in order to advance the policy of the statutory provisions which was to discourage the dishonest evasion of VAT.

26. The judge then considered a submission for the company that the facts and intentions of the site managers should not be attributed to the company because the case came within what was described as the Hampshire Land principle (see Re Hampshire Land Co [1896] 2 Ch 743); this principle has also been referred to as "the fraud exception" to attribution. In McNicholas, the company submitted that it was a victim of a fraud practised on it by the site managers and others. The judge held that the company could not sensibly be regarded as a victim of the fraud. It was submitted that the company would suffer a disadvantage if it were held that it was not entitled to deduct input tax as it had paid VAT in accordance with the dishonest invoices used in the fraud. Further, even if it were not denied the right to deduct input VAT it had suffered a cash flow disadvantage because it had paid the VAT shown on the dishonest invoices and only subsequently sought a credit in relation to input VAT.

27. In relation to the argument that the company was a victim of the dishonesty, the judge said:

> "55. In my judgment, the tribunal correctly concluded that there should be attribution in the present case, since the company could not sensibly be regarded as a victim of the fraud. They were right to hold that the fraud was 'neutral' from the company's point of view. The circumstances in which the exception to the general rule of attribution will apply are where the person whose acts it is sought to impute to the company knows or believes that his acts are detrimental to the interests of the company in a material respect. This explains, for example, the reference by Viscount Sumner in J C Houghton & Co v Nothard Lowe and Wills Ltd [1028] AC 1 at 19 to making "a clean breast of their delinquency". It follows that, in judging

> whether a company is to be regarded as the victim of the acts of a person, one should consider the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective. As the tribunal pointed out, in In re Supply of Ready Mixed Concrete (No 2)[1995] 1 AC 456 the company suffered a large fine for contempt of court on account of the wrongful acts of its managers. The fact that their wrongful acts caused the company to suffer a financial penalty in this way did not prevent the acts and knowledge of the managers from being attributed to it.
>
> 56. The [breach of duty exception] is founded in common sense and justice. It is obvious good sense and justice that the act of an employee should not be attributed to the employer company if in truth, the act is directed at, and harmful to, the interests of the company. In the present case, the fraud was not aimed at the company. It was not intended by the participants in the fraud that the interests of the company should be harmed by their conduct. In judging whether the fraud was in fact harmful to the interests of the company, one should not be too ready to find such harm. In my view, the cash flow point made by [counsel] comes nowhere near being serious enough to trigger the principle."

28. McNicholas was considered in some detail by the Court of Appeal and the House of Lords in Stone & Rolls Ltd v Moore Stephens [2009] 1 AC 139, see, in particular, the Court of Appeal decision at [50] – [54] and [71] – [72] per Rimer LJ and the speech of Lord Walker in the House of Lords at [153] – [154].

29. Greener Solutions raised much the same issues as arise in the present case. The taxpayer company used a third party to carry out transactions on its behalf. The third party knew that the transactions were connected with fraud. The taxpayer claimed repayment of the input tax it had incurred in relation to the transactions. HMRC denied the claim on the basis of the principles in Kittel. The question was whether the knowledge of the third party should be attributed to the taxpayer. At [11], the Upper Tribunal said that it had not been suggested that EU law required attribution of knowledge to a company for the purposes of VAT in a manner different from the operation of attribution under domestic law. It added that it was for the national court to ascertain how knowledge of an individual is to be attributed to a company.

30. In Greener Solutions, the FtT held that the principle it should apply was as follows:

> "The principle we derive from these authorities is that the Hampshire Land principle is of general application and applies to prevent the knowledge of the agent in breach of his duty to the company being attributed to a company where the company is a victim of his fraud. In determining whether there is a fraud against the company "one should consider the effect of the acts

> themselves, and not what the position would be if those acts eventually prove to be ineffective." And "In judging whether the fraud was in fact harmful to the interests of [the company], one should not be too ready to find such harm."

31. In Greener Solutions, HMRC did not challenge that statement of principle on their appeal to the Upper Tribunal and the Upper Tribunal agreed with the statement. The issue therefore was how the principle applied to the facts. In the course of applying the principle to the facts, the Upper Tribunal held that it was relevant to ask whether the fraud was aimed at the taxpayer. The Upper Tribunal also commented that the purpose of the principles in Kittel was to combat fraud and those principles would be seriously eroded if a taxpayer company could escape liability on the ground that it was an innocent company deceived by a fraudulent employee or director even where the company had been able to profit from the transaction conducted on its behalf. On the facts of the case, the Upper Tribunal held that the knowledge of the third party was to be attributed to the taxpayer.

The decision of the FtT

32. In addition to the parts of the Decision of the FtT which we have quoted above, the FtT discussed the legal principles which it should apply. It considered a number of authorities but it paid particular attention to the decision of the Upper Tribunal in Greener Solutions. At [12], the FtT said:

> "… it was made clear in *Greener Solutions* by reference to earlier authorities that (i) the scope of those whose knowledge could be imputed to the principal whose VAT was alleged to be connected with fraudulent deals was wide; the knowledge of all employees and agents who are involved in making of the relevant supplies is imputed to the taxpaying entity (ii) the fraud exception is limited to circumstances in which the alleged fraud would cause significant harm to the entity which seeks to rely on the exception; a neutral result (such as the entity being able to claim input tax) was not sufficient to trigger the fraud exception (iii) in determining the harm suffered by the entity seeking to rely on the exception, the test to be applied is on the basis that the fraud has succeeded, not taking account of the costs and results of the failure of that fraud (including in the VAT context the denial of input tax)."

33. The FtT then set out the issues which MSL had said in its letter of 25 September 2014 were in dispute, as follows:

> "(1) Are the activities of the person, which do not relate to misconduct of deals on behalf of MSL, relevant to the attribution of knowledge in respect of those deals?
>
> (2) Did the person whose acts and or knowledge it is sought to impute to MSL know or believe that his acts and or

knowledge, in the context of the agency agreement, were detrimental to the interests of MSL in this respect?

(3) Is MSL a true victim of fraud rather than simply being used as a vehicle for the commission of fraud against HMRC i.e. was the risk to his investment not limited to simply the possibility that HMRC would fail to re-pay its own or WIGIG's VAT repayment claims.

(4) In judging whether MSL is to be regarded as a victim of the acts for that person, should consideration be given to the effects of the acts themselves, rather than what the position would have been had this act actually proved to be effective i.e. what did the fraudulent individuals intend to happen.

(5) As such, should the exception to the general rule of attribution apply?"

34. The FtT set out the submissions which had been made to it on behalf of the parties. It then gave its reasons for its decision. Its reasons are somewhat repetitious but they include the following statements:

(1) Wigig was an effective agent for MSL and in principle its fraudulent knowledge could be attributed to MSL;

(2) MSL could not rely on the fraud exception to attribution primarily because, to take advantage of the fraud exception, the acts of MSL's agent had to be directly linked to the acts of which MSL was accused as principal and there was not a sufficient connection of that kind in this case;

(3) Greener Solutions made it clear that the fraud exception should be applied restrictively in the present context;

(4) there was not a direct connection between MSL's VAT transactions and the alleged bank fraud practised by Wigig on MSL; MSL's suggestion of a direct link was based on suppositions not stated in the assumed facts;

(5) the fraudulent actions of Wigig were not causative of MSL's VAT transactions;

(6) it was possible that Wigig's intention in accessing MSL's bank account when it knew that HMRC were disputing Wigig's VAT re-claims was to harm MSL; if the only fraud were the fraud on MSL's bank account that would be sufficient to trigger the fraud exception but that was not the fraud in point;

(7) even if there were an "overarching fraud" as contended by MSL, the harm done to MSL did not arise from the successful result of the agent's fraudulent activity;

(8) it was not possible to establish that the intended effect of the success of the relevant fraud was to cause harm to MSL.

The grounds of appeal

35. MSL has put forward the following grounds of appeal against the decision of the FtT:

(1) this case should be distinguished from McNicholas Construction and Greener Solutions because, in this case, MSL was the target of Wigig's fraud which caused MSL significant harm;

(2) the principle of attribution rests upon the presumption that the agent will not keep material facts from the principal; in McNicholas Construction and Greener Solutions it was perfectly reasonable to attribute the agent's knowledge to the principal as there was no fraud on the principal and the only victim was HMRC; in the present case, where there was a fraud on the principal it defied both logic and common sense to attribute the agent's knowledge to the principal;

(3) the FtT made assumptions as to the facts which were not correct;

(4) contrary to the findings of the FtT, there was an obvious connection between Wigig's fraud on MSL and the MSL trades; MSL had plainly demonstrated that the fact that the MSL trades were connected to fraud was relevant to Wigig's fraud on MSL;

(5) if MSL had known about Wigig's fraud on MSL, it would not have permitted Wigig to carry out the MSL trades;

(6) the FtT was wrong to distinguish between two frauds, one on MSL and one on HMRC; instead, there was one overarching fraud; the overarching fraud had two victims, MSL and HMRC but MSL was the primary victim; even if MSL was only a secondary victim, as a matter of common sense and justice, the knowledge of Wigig as to the MSL trades should not be attributed to MSL;

(7) a decision in favour of MSL on the issue of attribution would not undermine the policy in Kittel; in straightforward cases of a principal using an agent to carry out trades connected with fraud, the "fraud exception" will not apply; the "fraud exception" will only apply where the agent is engaged in a fraud against the principal going well beyond the normal incidence of carrying out deals connected with VAT fraud.

36. In Mr Cox's skeleton argument, prepared for the appeal to the Upper Tribunal, he continued to rely on McNicholas Construction and Greener Solutions. He submitted that the authority of these decisions was not affected by the decision of the Supreme Court in Bilta. He addressed the FtT's finding that the fraud by Wigig on MSL's bank account was not relevant to the MSL trades. In that respect, MSL submitted that the fraud on MSL was relevant to the MSL trades

because it made it illogical or absurd to suppose that Wigig would inform MSL of the connection of the MSL trades to fraud.

37. Mr Cox's skeleton argument also addressed the application of the policy identified in Kittel in a case where HMRC contended that the knowledge of an agent, that the transactions were connected with fraud, was to be attributed to the principal. He submitted that it was repugnant to justice and common sense and the principle of proportionality that a taxpayer which was itself the object of a fraud by its agent should have the knowledge of the agent attributed to it and thereby be regarded as "an accomplice" (this is the phrase used in Kittel at [57]) of the persons committing the fraud on HMRC.

Bilta

38. We referred earlier to the decision of the Supreme Court in Bilta. We will now summarise the facts of that case and the principles established by it.

39. The first and second defendants were the sole directors of the first claimant, a company incorporated in England and registered for the purposes of VAT. The company purchased carbon credits recorded on the Danish Emissions Trading Agency Registry from traders carrying on business outside the United Kingdom, including the sixth defendant, a company incorporated in Switzerland, the sole director of which was the seventh defendant. Accordingly, the purchases were not subject to VAT. The first and second defendants, as directors, owed fiduciary duties to the company. The second and third claimants, the company's liquidators, claimed that a conspiracy existed to injure and defraud the company by trading in carbon credits and dealing with the resulting proceeds in such a way as to deprive the company of its ability to meet its VAT obligations on such trades. It was claimed that the defendants were knowingly parties to the business of the company with intent to defraud creditors and for other fraudulent purposes, and should therefore be ordered under section 213 of the Insolvency Act 1986 to contribute to the company's assets. The sixth and seventh defendants, who were claimed to have dishonestly assisted the conspiracy, applied for orders that the claim be summarily dismissed as against each of them on the ground, among others, that the claim by the company was precluded by an application of the maxim *ex turpi causa non oritur actio* on the basis that the pleaded conspiracy disclosed the use of the company by its directors and their associates to carry out a carousel fraud, the only victim of which was HMRC, and since the company was a party to the fraud it could not claim against the other conspirators for losses which it had suffered as a result of the fraud which it had carried out. This ground was rejected, in turn, by the High Court, the Court of Appeal and the Supreme Court.

40. The Supreme Court, consisting of seven judges, considered in detail the legal principles as to illegality and as to attribution. As regards illegality, Lord Neuberger stated at [15] that the relevant principles needed to be considered by the Supreme Court in a future case. Since this decision, the Court of Appeal has stated that there is uncertainty as to the proper approach to a defence based on illegality: see Sharma v Top Brands Ltd [2016] PNLR 12 at [37]. However, the present appeal does not involve the defence of illegality. As regards

attribution, the judgments of the Supreme Court do not suffer from the same uncertainty and can now be regarded as an authoritative statement of the principles to be applied. As explained by Lord Neuberger at [7], the detailed judgments of Lord Sumption and of Lords Toulson and Hodge are essentially to the same effect as regards attribution. We consider that the judgments dealing with the subject of attribution do throw important new light on the principles to be applied with the result that some of the reasoning in earlier cases can no longer be regarded as valid.

41. In Bilta, the judgments considered the rules as to attribution of an agent's knowledge to a principal and when attribution should apply. It was stressed that the key to the decision as to whether there is attribution of such knowledge depends on considerations of context and purpose. In the present case, there is no dispute that the primary rules as to attribution would result in the knowledge of Wigig being attributed to MSL, subject to MSL's contention that this primary rule is subject to an exception, conventionally referred to as "the fraud exception". Accordingly, we do not need to consider in detail the judgments in Bilta in so far as they consider the primary rules of attribution but we can concentrate on what is said about "the fraud exception". We should however note, as a preliminary matter, that it is probably better to regard the so called exception as not a true exception but just part of the general rules dealing with considerations of context and purpose: see per Lord Neuberger at [9], per Lord Mance at [37] – [44] and per Lords Toulson and Hodge at [181]. Further, the expression "the fraud exception" is not an accurate statement of the scope of the exception (if it is an exception at all) because the exception applies in cases which do not involve fraud and includes certain cases of breach of duty. Notwithstanding these comments, it is convenient to describe the breach of duty exception as an exception to the primary rules of attribution, as that is how the argument was presented to us on this appeal.

42. When discussing the breach of duty exception, the Supreme Court in Bilta approved a distinction made by Patten LJ in the Court of Appeal in that case. The distinction was explained in detail by Lord Sumption at [84] in the passage set out below, although Lords Toulson and Hodge also approved the drawing of this distinction (see at [208]):

> "84 … Patten LJ, delivering the leading judgment, considered that the answer depended on the duty which was sought to be enforced and the parties between whom the issue was raised. In an action against the company by a third party who had been defrauded, the company was responsible. But it did not follow that the company was to be treated as responsible for a fraud for the purposes of an action against the dishonest director. In such an action, the illegality defence cannot be available, whether the damages claimed arose from the liability which the company was caused to incur to a third party or from the direct abstraction of the company's assets. Patten LJ's reasoning on these points is encapsulated in paras 34 – 35 of his judgment:
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> "34. … attribution of the conduct of an agent so as to create a personal liability on the part of the company depends very

much on the context in which the issue arises. In what I propose to refer to as the liability cases like El Ajou, Tan, McNicholas and Morris, reliance on the consequences to the company of attributing to it the conduct of its managers or directors is not enough to prevent attribution because, as Mummery LJ pointed out, it would prevent liability ever being imposed. As between the company and the defrauded third party, the former is not to be treated as a victim of the wrongdoing on which the third party sues but one of the perpetrators. The consequences of liability are therefore insufficient to prevent the actions of the agent being treated as those of the company. The interests of the third party who is the intended victim of the unlawful conduct take priority over the loss which the company will suffer through the actions of its own directors.

"35. But, in a different context, the position of the company as victim ought to be paramount. Although the loss caused to the company by its director's conduct will be no answer to the claim against the company by the injured third party, it will and ought to have very different consequences when the company seeks to recover from the director the loss which it has suffered through his actions. In such cases the company will itself be seeking compensation by an award of damages or equitable compensation for a breach of the fiduciary duty which the director or agent owes to the company. As between it and the director, it is the victim of a legal wrong. To allow the defendant to defeat that claim by seeking to attribute to the company the unlawful conduct for which he is responsible so as to make it the company's own conduct as well would be to allow the defaulting director to rely on his own breach of duty to defeat the operation of the provisions of sections 172 and 239 of the Companies Act whose very purpose is to protect the company against unlawful breaches of duty of this kind. For this purpose and (it should be stressed) in this context, it ought therefore not to matter whether the loss which the company seeks to recover arises out of the fraudulent conduct of its directors towards a third party (as in McNicholas and Morris) or out of fraudulent conduct directed at the company itself which Sir Andrew Morritt C accepted was what is alleged in the present case. There is a breach of fiduciary duty towards the company in both cases."

43. The point made by Patten LJ, that the breach of duty exception critically depended upon the identity of the persons between whom the issue arose, appears to have been a new insight. Lord Sumption said so at [86]:

"86 The problem posed by the authorities is that until the Court of Appeal's decision in this case, they have generally treated the imputation of dishonesty to a company as being governed by

> tests dependent primarily on the nature of the company's relationship with the dishonest agent, the result of which is then applied universally. This was the point made by Lord Walker in Stone & Rolls at para 145, from which he resiled in Moulin. The fundamental point made by the Court of Appeal in this case and the Court of Final Appeal in Moulin is that, while the basic rules of attribution may apply regardless of the nature of the claim or the parties involved, the breach of duty exception does not. I agree with this. It reflects the fact that the rules of attribution are derived from the law of agency, whereas the fraud exception, like the illegality defence which it qualifies, is a rule of public policy. Viewed as a question of public policy, there is a fundamental difference between the case of an agent relying on his own dishonest performance of his agency to defeat a claim by his principal for his breach of duty; and that of a third party who is not privy to the fraud but is sued for negligently failing to prevent the principal from committing it."

44. At [87] and [88], Lord Sumption further discussed the distinction to be made which depended upon the parties between whom the issue arose, he said:

> "87 There are three situations in which the question of attribution may arise. First, a third party may sue the company for a wrong such as fraud which involves a mental element. Secondly, the company may sue either its directors for the breach of duty involved in causing it to commit that fraud, or third parties acting in concert with them, or (as in the present case) both. Third, the company may sue a third party who was not involved in the directors' breach of duty for an indemnity against its consequences.
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> 88 In the first situation, the illegality defence does not arise. The company has no claim which could be barred, but is responding to a claim by the third party. It will be vicariously liable for any act within the course of the relevant agent's employment, and in the great majority of cases no question will arise of attributing the wrong, as opposed to the liability, to the company. Where the law requires as a condition of liability that … the company should be personally culpable, as Lord Nicholls appears to have assumed it did in Royal Brunei Airlines, the sole function of attribution is to fix the company with the state of mind of certain classes of its agents for the purpose of making it liable. The same is true in cases like McNicholas, involving statutory civil penalties for quasi-criminal acts. It is also true of cases like El Ajou where the relevant act (receipt of the money) was unquestionably done by the company but the law required as a condition of liability that it should have been done with knowledge of some matter. This will commonly be the case with proprietary claims, where vicarious liability is irrelevant."

45. At [93], Lord Sumption addressed arguments as to whether a person was a primary or secondary victim:

> "93 This makes it unnecessary to address the elusive distinction between primary and secondary victimhood. That distinction could arise only if the application of the breach of duty exception depended on where the loss ultimately fell, or possibly on where the culpable directors intended it to fall. If, however, the application of the exception depends on the nature of the duty and the parties as between whom the question arises, the only question is whether the company has suffered any loss at all."

46. It is also relevant to refer to the judgment of Lord Walker of Gestingthorpe delivered in the Hong Kong Court of Final Appeal in Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue (2014) 17 HKCFAR 218, which was decided after the decision of the Court of Appeal in Bilta but before the decision of the Supreme Court in that case. Lord Walker regarded the insight of Patten LJ (referred to above) in Bilta as particularly illuminating. At [106], Lord Walker summarised the law as to the breach of duty exception in a number of propositions which included the following:

(1) the underlying rationale of the breach of duty exception is to avoid the injustice and absurdity of directors or employees relying on their own awareness of their own wrongdoing as a defence to a claim against them by their own corporate employer;

(2) the exception does not apply to protect a company where the issue is whether the company is liable to a third party for the dishonest conduct of a director or employee;

(3) the supposed distinction between primary and secondary victims, although sometimes a useful analytical tool, is ultimately much less important than the distinction between third party claims against a company for loss to the third party caused by the misconduct of a director or employee, and claims by a company against its director or employee (or an accomplice) for loss to the company caused by the misconduct of that director or employee.

The application of Bilta to the facts of this case.

47. It is clear from the decision of the Supreme Court in Bilta that it is important to have regard to the context in which the question of attribution arises and the persons who are relevant to the application or non-application of the breach of duty exception. If the question of attribution arose as between MSL and Wigig, for example in a claim by MSL against Wigig for damages for fraud, it is clear from Bilta that Wigig could not argue that its knowledge of the fraud should be attributed to MSL so as to give Wigig a defence. It would make no difference whether MSL was the primary victim of the fraud or only a secondary victim. When considering whether MSL had suffered loss, it would be irrelevant to consider whether MSL would have suffered loss if the fraud

on HMRC had succeeded. In assessing whether the actions of Wigig were harmful to MSL, there would be no question of the court being slow to find such harm; the court would make the findings which were appropriate on the evidence before it. In other words, the distinctions which were drawn in McNicholas and applied in Greener Solutions as to when to apply the breach of duty exception would have no part to play in the context of a claim by MSL against Wigig.

48. If the facts of McNicholas were to recur and the matter were to be analysed after Bilta, we do not consider that a court or tribunal would adopt the original reasoning in McNicholas. That reasoning was resorted to when it was not appreciated, as it is now appreciated, that one could hold that the knowledge of a relevant person could be attributed to the company in a claim by a third party against the company and, at the same time, could hold that there was no such attribution in a claim by the company against the person who was in breach of duty. After Bilta, the reasoning in a McNicholas case would simply be that as between the company and HMRC, the company was responsible for the wrongdoing committed for it by the wrongdoer, even though that involved a breach of duty owed by the wrongdoer to the company.

49. We consider that the position is even more clear in the present case. MSL claims to be entitled to deduct input tax in relation to certain transactions. Those transactions were carried out for it by Wigig. MSL relies upon the actions of Wigig for the purpose of asserting an entitlement to deduct input tax. We consider that, applying the principles in Bilta, MSL is not able to rely upon the actions of Wigig to claim that entitlement and, at the same time, to resist the attribution to it of the knowledge of Wigig that the transactions were connected with fraud.

50. Following the decision in Bilta, we do not consider that it is necessary to consider whether MSL was a primary victim or a secondary victim. Nor is it necessary to ask whether Wigig committed two frauds on MSL or only one overarching fraud. The first suggested fraud was carrying out trades on behalf of MSL when it knew (if it did) that HMRC might be able to resist the deduction of input tax on the ground that the trades were connected with fraud. The second suggested fraud was Wigig drawing money from MSL's bank account and using it for its own purposes and, in particular, purposes not authorised by its entitlement to draw on the account. We consider that it does not matter whether these two alleged frauds were connected or not.

51. Some of the cases dealing with the breach of duty exception make the point that where the exception applies, it is unlikely that the agent would make a clean breast of the wrongdoing to the principal. However, the cases do not establish that the question of attribution should ultimately turn on a factual inquiry as to whether it is likely in a particular case that the agent would make a clean breast of the wrongdoing to the principal. Accordingly, we do not consider that the answer in the present case involves such a factual inquiry. Accordingly, it is nothing to the point to submit that on the facts of this case it was unlikely that Wigig would admit to MSL that it was guilty of any kind of wrongdoing.

52. The result of this reasoning is that even if we were to assume all of the facts expressly set out in the list of facts to be assumed and the suggested inferences from those facts and also the matters which Mr Cox referred to in his note, we would conclude that as between MSL and HMRC the knowledge of Wigig is to be attributed to MSL; MSL is not able to invoke the breach of duty exception to allow it to rely upon the trades which Wigig effected for it and at the same time to deny attribution of Wigig's knowledge to it.

53. In these circumstances, it is not appropriate to consider what our answer would have been if we had sought to apply the various distinctions identified in McNicholas and Greener Solutions. Nor is it necessary to consider whether MSL is entitled to ask us to proceed on the basis of facts which were not expressly set out in the list of facts to be assumed.

54. Mr Cox submitted that the conclusion which we have described above, based as it is on the application of the domestic law of attribution, would be regarded as infringing the requirement of proportionality in EU law. He submitted that the reasoning in Kittel would not extend to a case like the present where it is to be assumed that MSL did not know, nor ought it to have known, that the trades were connected with fraud and it would be disproportionate to deny it its entitlement to deduct input tax by reason of the knowledge of Wigig.

55. Mr Cox did not develop his submission as to proportionality in any detail. We note that in Greener Solutions, the Upper Tribunal stated that the question of attribution was to be dealt with as a matter of national law. Further, we do not see anything disproportionate in attributing Wigig's knowledge to MSL when MSL seeks to rely upon the actions of Wigig for the purpose of asserting its entitlement to deduct input tax. In the end, Mr Cox's submission came down to the assertion that we ought not to regard MSL as "an accomplice" (the phrase used in [57] of Kittel) by attributing to it the knowledge of Wigig when Wigig was defrauding MSL. However, this submission ultimately begs the question as to whether Wigig's knowledge is attributed to MSL under domestic law. If Wigig's knowledge is attributed to MSL, then as between MSL and HMRC, MSL is an accomplice to the others engaged in the fraudulent trades. Conversely, if Wigig's knowledge is not attributed to MSL, then MSL is not to be regarded as an accomplice to those others. It is also nothing to the point that in the context of a claim by MSL against Wigig, where Wigig's knowledge is not attributed to MSL, then MSL would not be regarded as an accomplice of Wigig.

The overall result

56. In the result, the appeal will be dismissed.

Costs

57. Finally, we direct that any applications as to costs are to be made in writing, to be served on the other party and on the Upper Tribunal within one month of the date of release of this decision.

MR JUSTICE MORGAN **JUDGE GREG SINFIELD**

RELEASE DATE: 17 JUNE 2016