[2011] UKFTT 792 (TC)

TC01628

Appeal number: MAN/2007/0671

VAT – MTIC – clean chain – transactions connected with fraud via contra-traders? – yes – appellant knew? – yes – appeal dismissed.

FIRST-TIER TRIBUNAL

TAX

MATRIX EUROPE LIMITED (IN LIQUIDATION)	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

TRIBUNAL: Richard Barlow (TRIBUNAL JUDGE)
Alban Holden

Sitting in public in Manchester on 13-15, 18-22, 25-29 October 2010, 1 and 2 November 2010. Subsequent written submissions concluded 1 September 2011.

Michael Patchett-Joyce instructed by Dass & Co solicitors for the Appellant

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

DECISION

1. This is the appeal of Matrix Europe Limited, in liquidation, against the decisions of the respondents to deny the appellant credit for and recovery of input tax in respect of £1,797,830 for the monthly period of April 2006 and £1,756,773.38 and £186,560 for the monthly period of May 2006. We will refer to all tax periods in the form 04/06, by way of example, to refer to a period ending April 2006.

2. Had the respondents agreed to credit the appellant with the sums in dispute, it would have received large repayments for both periods as the outputs to which the disputed input tax relates were zero rated dispatches to EU countries or exports to Canada.

3. By way of introduction only, we mention that the appeal is what is called, in the jargon that has become well known through other appeals, an MTIC case and the appellant's transactions are what are known as clean chain broker transactions in which recovery of input tax is denied on the basis that those transactions are connected with fraudulent transactions through a contra-trader and the appellant either knew or should have known of that connection. In using the terms clean and dirty chains and broker, contra-trader or defaulter we do so only for convenience and, as has been pointed out before by the Tribunal (see the decision in *Totel Distribution Ltd*), use of those terms, although now well understood, cannot be allowed to prejudge or influence the Tribunal's decision one way or the other as to the correct legal and factual position.

4. We propose to deal with the decision by first setting out the legal issues raised in this appeal and then dealing with the factual issues. The factual issues will address three principal questions requiring findings of fact which we summarise in the following way. Have the respondents proved there were relevant fraudulent defaults? Have the respondents proved that there was a connection, in the relevant sense, between the appellant's transactions and those fraudulent defaults? (The respondents contend the connection was through contra-traders). If so, have the respondents proved that the appellant knew or should have known of the connection which was such as to have entitled them to deny a credit for input tax under the applicable legal principles?

The legal issues.

5. In *Kittel –v- Belgium* [2008] STC 1537 the ECJ held that on the one hand, at [60], where a recipient of a supply buys goods and "did not and could not know that the transaction concerned was connected with fraud" then the Member State in which the recipient is registered for VAT cannot provide, by its domestic law, that such a transaction is void and cannot provide that input tax is not claimable on the transaction. On the other hand, at [61], the ECJ held that "where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that person entitlement to the right to deduct".

6. At [51] the ECJ had also held that a trader who has taken every precaution to ensure that his transaction is not connected with fraud, must be allowed to claim input tax. At [52] the Court held that a person who "did not and could not" know that his transaction was connected with fraud would be entitled to claim input tax despite a connection between his transaction and a VAT fraud.

7. The Court did not explain specifically what it meant by "should have known" but [51] and [52] of the judgment suggest that a trader should take, at least, reasonable precautions to avoid being involved in a transaction connected with fraud. Taken literally "every precaution" and "could not know" might suggest that the test is a very strict one. But bearing in mind [56] to [58] of the judgment we do not read it in that way. The Court used the word "should" for the first time in paragraph [56] and explained the rationale of the rule it then set out at [61]. It said that the rationale was that a person who either knew or should have known of the connection with fraud is to be "regarded as a participant" and that he "aids the perpetrators"; which appears to suggest a degree of blame that would not have attached to a person simply for overlooking a precaution that he might have taken or who could have known of a connection but only in some obscure way.

8. The Court also explained the underlying rationale of the rule in terms of its being for the better prevention of fraud.

9. In light of an argument Mr Patchett-Joyce put to us concerning whether the right to deduct input tax never arises or is lost in cases where a transaction is connected with fraud, which we deal with below, we also note that at [60] the Court referred to the fact that the national law of Belgium, which was in issue, caused the taxpayer to lose the right to deduct input tax and then at [61] it used the neutral phrase that the national court should 'refuse entitlement' to deduct without further elaboration. Advocate General Ruiz-Jarabo Colomer had also referred to the loss of a right to deduct at [62] of his opinion.

10. It is well established that the right to deduct input tax is exercisable immediately when a transaction occurs and the ECJ emphasised this in *Kittel*. One consequence of that is that the applicable circumstances known to the appellant at the time of a transaction and the actions taken by the appellant at or before the transaction occurred are the relevant facts and that information acquired by the appellant subsequently will be irrelevant. Actions taken by the appellant after a transaction will also be irrelevant as such but, of course, they may shed light on what the appellant knew at the time if, for example, they appear to amount to attempts to cover up the true circumstances applying at the time of the transaction.

11. In its judgment in *Mobilx and others –v- Revenue and Customs Commissioners* [2010] STC 1436 the Court of Appeal considered in detail the issues raised in cases of this sort and Moses LJ elaborated on the meaning of the "should have known" concept. He held that it is not enough for HMRC to prove that the circumstances were such that it was more likely than not that a transaction in question was connected with fraud and that what they must prove is that the transaction was connected with fraud.

12. The *Mobilx* litigation included some decisions relating to contra-trading. Moses LJ specifically held that it matters not if the input transaction in question precedes the transaction which gives effect to the fraud. He held that if the taxable person is proved to have entered into a transaction that he knew or should have known, at the time of entering into it, was at that time connected with fraudulent evasion or would be so connected later; that is sufficient to deny recovery of input tax.

13. Moses LJ also held that, where an issue arises about what a person should have known, it is relevant to consider whether the only reasonable explanation for the circumstances surrounding the transaction is that it is connected with fraud. He also stressed the relevance of circumstantial evidence generally.

14. Moses LJ referred to the refusal of the right to deduct at [5] and emphasised the relevance of the absence of the objective criteria for deduction at, for example, [41]. Mr Patchett-Joyce argued that that means that the denial of input tax depends upon a finding that the transaction was outwith the scope of transactions on which input tax is recoverable rather than upon a finding that the right has been lost. We have already mentioned that the ECJ referred to a loss of the right. The judgment of Moses LJ read as a whole certainly suggests that he thought the correct analysis is that the right does not arise rather than is lost.

15. We doubt that there is any genuine practical difference between the two points of view, if indeed there are two points of view; except in purely philosophical terms. Whether a right never crystallizes or is lost immediately after crystallizing seems to us to make no practical difference, especially as the question has to be determined on the facts as they stood at the time of the transaction itself.

16. Mr Patchett-Joyce's purpose in raising this issue was to argue that HMRC had originally decided that the input tax should be denied on the basis that the right had been lost but later argued that the right had never arisen and he argued that that constituted a breach of the principle of legal certainty. Even if the Commissioners have changed their minds in that way, we hold that it is irrelevant. The issue before the Tribunal is whether the appellant is entitled to deduction of input tax as a matter of law and that cannot be affected by the changing opinions of the parties to this litigation about how they put their case. The principle of legal certainty requires that the law should be capable of being known by persons subject to it, but not that parties to litigation must always and consistently put forward correct legal arguments. The correctness of the arguments is a matter for the Tribunal to rule upon.

17. A further issue was raised by Mr Patchett-Joyce concerning the meaning that should be attached to the phrases "taking part in a transaction connected with fraudulent evasion of VAT" and "participating in a transaction connected with fraudulent evasion of VAT" respectively in [56] and [59] of the judgment in Kittel.

18. By reference to the French versions of *Kittel* and of the judgment of the ECJ in Case C-258/09 *Criminal proceedings against R –v- Generalbundesanwalt beim Bundesgerechtshof, Finanzamt Karlsruhe Durlach* and by comparison with the English versions of those judgments Mr Patchett-Joyce showed us that the phrase "il

participait a une operation impliquée dans une fraude" which appears in both *Kittel* and *Criminal proceedings against R* was translated into English in *Kittel* as "taking part in a transaction connected with fraudulent evasion" but in *Criminal proceedings against R* it was translated as "he was participating in a transaction aimed at evading VAT".

19. Secondly, by reference to the French version of *Kittel* Mr Patchett-Joyce drew our attention to the fact that the phrase "knew or should have known" at [56] is a translation from the French, which was the language of the case, of the phrase "savait ou aurait du savoir". He invited us to translate "aurait du savoir" as "would have had to have known".

20. From those differences in translation Mr Patchett-Joyce invited us to regard the translation in the English version of *Kittel* as inaccurate and to consider the issues in this case on the basis that the correct question for us to decide is whether the respondents have proved that the appellant "knew or would have had to have known that it was taking part in a transaction aimed at evading VAT".

21. As far as taking part in a transaction "aimed at evading VAT" is concerned we note and hold that the phrase "a transaction aimed at evading VAT" only refers to the effect of the transaction and does not necessarily imply anything about the state of mind of a participant in the transaction. In other words even if we decided we should adopt that phrase rather than "connected with fraudulent evasion" we would not necessarily accept that it would make any difference to the way the transaction should be analysed. If there is a difference it amounts only to a nuance. It might be said that "aimed at" suggests a more direct connexion with the actual fraud than "connected with" but we consider any difference to be insignificant at most.

22. Concerning "would have had to have known" as a substitute for "should have known" we agree that were that substitution to be made it would be significant. If someone "would have had to have known" something that person in effect "must have known" it. The difference between "would have had to have known" and "must have known" appears to us to amount only to a suggestion about how the state of knowledge is proved. "Would have had to have known" suggests that the person concerned is shown to have known a fact because it is a logical consequence of other proven facts that that state of knowledge must also have existed. Therefore "would have had to have known" is just another way of saying "must have known". That is quite different from a situation where a person "should have known" something which in itself implies that he did not actually know it.

23. The ECJ quite clearly intended to make a distinction between two separate concepts when it used the phrase "savait ou aurait du savoir" otherwise it would not have mentioned both separated by "ou" and so we do not agree that the alternative interpretation put forward by the appellant is correct.

24. In addition, we would be very reluctant to re-interpret a judgment translated into English by a no doubt highly qualified translator using only our own inadequate

knowledge of French. We heard no evidence from an expert witness about the meaning of the phrases in question.

25. We also reject Mr Patchett-Joyce's submissions concerning the relevance of the remarks made by Lewison J in *Livewire –v- HMRC* [2009] STC 643 at [102] and [103] to the effect that in a contra-trading case there are two frauds namely the dirty chain default and its cover up by the contra-trader and that the clean chain broker must be shown to have known or to be a person who ought to have known of one or both of those frauds. The learned judge added: "If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know". At [105] the learned judge said: "In other words, if the taxable person knew of the fraudulent purpose of the contra-trader, whether he had knowledge of the dirty chain does not matter".

26. In *HMRC –v- Brayfal* [2011] STC 1338 at [19] Lewison J, after noting that there is no fraud in the clean chain, said that the clean chain broker must be shown to have known or to have had the means of knowledge that his transaction is connected with fraud and "he must either know or have the means of knowledge that the contra-trader is a fraudster". We assume the judge's reference to the means of knowledge is shorthand for the "should have known" concept as understood in the authorities because having the means of knowledge by itself is not sufficient to disallow input tax. But the relevance of the passage is that the reference to the contra-trader is to him as a fraudster without any specific type of fraud being specified. The judge then added that the taxpayer's input tax claim would also be disallowed if he had knowledge or the means of knowledge of the dirty chain.

27. We interpret Lewison J's remarks as meaning that the taxpayer must know or be a person who should have known of a fraud before input tax will be disallowed and the fraud in question will in fact be either the dirty chain fraud or the cover up by the contra-trader. But he need not know or be a person who should have known what precise form the fraud takes as long as he knew or should have known there was a fraud of some type being committed by the contra-trader or alternatively that he actually knew or should have known about the dirty chain fraud, the latter being less likely to be capable of proof where the claimant is in the clean chain because he will have dealt only with the contra-trader. That interpretation of Lewison J's remarks is also more in tune with the judgment of Briggs J in *Megtian –v- HMRC* [2010] STC 840 at [35] to[39] (especially [38]) and indeed to *Mobilx* and *Kittel* itself.

28. The Tribunal was urged by Moses LJ not to over elaborate the tests set out in *Kittel* and if we have here done so it is only to make it clear that we have addressed Mr Patchett-Joyce's detailed submissions.

29. We were urged to refer a question arising in the case to the Court of Justice of the European Union or to delay our decision until that Court had ruled on two cases from Hungary and one from Bulgaria.

30. The first case is *Mahageben –v- Menzet Ado es Vamhivatal Del-dunatuli Regionalis Ado Foigazgatosaga* (C-80/11) (Mahageben). In that case the issue is whether National Law is compatible with EU Law where the former makes the deduction of input tax conditional upon the taxpayer claiming it being in possession of documents other than the supplier's invoice and upon the claiming party having carried out specified due diligence. As UK law does not require any such documents or due diligence that case does not have any relevance to this appeal. Questions of due diligence and indeed the possession of documents other than an invoice may be relevant as a matter of evidence in respect of questions related to whether a taxpayer knew or should have known that a transaction was connected with fraud but UK law does not prescribe how those questions should be determined.

31. The second case is *Peter David –v- Same* (C-142/11) (David). The *David* case raises similar issues to the *Mahageben* case. It also raises an issue as to whether the refusal of deduction requires the tax authority to show that the taxpayer claiming the deduction was aware of the unlawful conduct or even colluded in it. The *Kittel* line of cases makes it clear, in our opinion, that the answer to that question is that the person claiming deduction must be proved to have known or be a person who should have known about the unlawful conduct.

32. The third case is *Bonik EOOD –v Direktor na Direktsi Obzhalvane I upravlenie na izpalnenieto, Varna* (C-285/11) (Bonik). The *Bonik* case raises issues somewhat similar to those in issue in this appeal but the questions referred appear to be related to whether a strict liability can give rise to a refusal of input tax recovery and whether the burden of proof can be imposed on the claiming party to show that other parties in the chain of transactions had not acted unlawfully. The established case law in the UK precludes any strict liability and places the burden of proof on HMRC so that in those respects the outcome of the *Bonik* case could not assist the appellant in this case but could put it at a disadvantage it does not presently suffer. A question appears to have been raised in the *Bonik* case as to whether the National Law should specifically provide for the loss or refusal of the right to deduct or whether that is inherently provided for in the concepts established by the VAT Directives themselves. The *Kittel* line of cases makes it clear, in our opinion, that National Law does not have to make provision for the exclusion of or the loss of the right to deduct before those consequences follow from a connection with fraud in the circumstances described.

33. Accordingly we do not hold ourselves bound to refer a question or await the outcome of those cases before reaching our decision.

The allocation/connection question.

34. HMRC, at one stage in the progress of their enquiries and decision making in this appeal, thought it necessary when considering whether to disallow clean chain input tax (ie the appellant's input tax), to 'allocate' the clean chain transactions to one or more of the dirty chain transactions as a sort of counter to a tax default in the dirty chain equal to the input tax claimed by the appellant. They did so purely arbitrarily in the sense that there was no particular connection between any of the clean chain

transactions in the hands of the appellant and any transaction related to a tax default in the hands of the contra-trader or, for that matter, the defaulter in the dirty chain.

35. It appears that HMRC thought the allocation was necessary to avoid any double or excessive recovery of tax in the sense that, if the input tax disallowed in all the clean chain transactions related to a particular contra-trader exceeded the defaults in all the dirty chain transactions of that contra-trader in any particular tax period, they would have disallowed more input tax than they had lost by way of output tax fraud.

36. *Kittel* and other authorities show that recovery of input tax is disallowed where there is a connection with VAT fraud because of that connection and the better to combat the fraud. In theory there could be a case where, as a result of denying input tax to one or more parties and recovering output tax from some others, HMRC would happen to be better off than they would have been had all parties acted legally. As was confirmed in *Calltell Telecom –v- HMRC* [2009] STC 2164 that is not a bar to HMRC refusing the claim for input tax. In other words the allocation exercise had never been necessary.

37. We mention this question only because Mr Patchett-Joyce argued that it would be disproportionate and contrary to principles of EU law for the commissioners to disallow input tax when they could, and he argued should have, pursued other parties such as the defaulting traders for the output tax. Indeed his submissions appeared to go as far as to say that the appellant should not be denied its claims for input tax even if it had proved impossible for the commissioners to recover the output tax of the defaulting traders. The principles stated in *Calltell*, *Mobilx* and *Kittel* make it clear that the limiting factor in denying recovery of input tax is whether the person claiming it knew or ought to have known of the connection with the fraud. It is at least inherent in the reasoning of the Courts in those cases that it is not disproportionate to disallow the input tax where the person claiming it did know or should have known of the fraud and that that is so even if others have escaped the consequences of their involvement in the fraud and even if their involvement is more direct than that of the person being refused input tax. A defaulting missing trader who has absconded without paying tax is arguably more directly connected with the consequences of the fraud and has more directly benefitted from it than a clean chain broker who has been denied input tax. The clean chain broker may only have been denied input tax on the basis he “should have known” so that he is being denied it on a basis akin to negligence compared with the missing trader who has got away with outright fraud. Those circumstances must have been obvious to the Courts, even in cases where they did not expressly advert to those facts, but it clearly made no difference to the outcome.

38. As we have already pointed out, the Courts have not thought it necessary to define what form the necessary connection between a clean chin transaction and the fraud must take.

39. In this appeal the Commissioners allege that the clean chain transactions were all connected with the frauds in one or more of three ways. First, the contra-traders, by entering into them as apparently normal sales, incurred output tax liabilities which

they used to offset and therefore disguise the huge claims they were making for input tax in respect of the dirty chains in which they acted as brokers (exporters). That disguise operated when they made their tax returns and they thereby reduced the likelihood that HMRC would verify the return; which they often did when asked for a refund but less often did when they were being paid tax. Secondly, the contra-traders gave the impression, by making these sales as internal UK transactions, that they were operating normal legitimate businesses. Thirdly, the payments made by the appellant when buying goods from the contra-traders provided funds for those traders to operate their businesses including the dirty chain transactions.

40. It will be necessary for us to make findings, based on the evidence, about the connections between the appellant's transactions and any fraud based on the evidence.

The evidential issues.

41. The appellant has put the respondents to proof of the allegations that the contra-traders and the defaulters in the dirty chains acted fraudulently. We will deal, in turn, with the evidence relating to each of the seven alleged contra-traders and the alleged defaulting traders for the transactions relating to those contra-traders in the relevant periods.

42. Then we will deal with the evidence relating to the appellant and the appellant's own evidence.

Alleged contra-trader Starmill International Limited (Starmill).

43. The appellant entered into seven deals with Starmill in the appellant's one month accounting period 04/06. Those deals are identified as seven transactions by the appellant's invoices and they all involved goods purchased by Starmill from the same German supplier (Global Mobile Leasing Gmbh). Starmill then sold the goods to the appellant which sold them to the same Belgian purchaser (2Trade Bvba). Four of the deals were invoiced by Global, Starmill and the appellant on 21 April 2006. The remaining three were invoiced by Global and Starmill on 26 April 2006 and by the appellant on 27 April 2006.

44. The total value of those sales by Global to Starmill was £4,995,825 (in effect exclusive of tax as Starmill had to account for acquisition tax but had an equal claim for input tax). The net value of sales by Starmill to the appellant was £5,030,250 giving Starmill a mark up of £34,425 which, as there were 71,000 units of goods, was an average mark up of 49p per item (rounded). The appellant had to pay a VAT inclusive price on its purchases from Starmill in which the VAT element amounted to £880,293.76. That was output tax payable to HMRC by Starmill and the same amount was claimed as input tax by the appellant. The appellant's purchases from Starmill therefore had a tax inclusive price of £5,910,543.70.

45. The appellant sold the goods to 2Trade for £5,331,150 by way of a zero-rated sale. At that point the appellant had purchased the goods from Starmill at a tax inclusive price of £5,910,543.70 and so the appellant had had to fund the difference which is £579,393.70. The appellant's total mark up on net figures, ie if the input tax

is repaid, would be £5,331,150 minus £5,030,250 which is £300,900 or £4.24 per unit (rounded).

46. Starmill was rendering VAT returns monthly so that one of its VAT periods coincided exactly with the appellant's April 2006 period. HMRC allege that, during April 2006, Starmill dealt with a number of transactions as a broker making zero rated supplies to customers abroad and so reclaimed input tax charged to it by its UK suppliers. HMRC allege that a number of those transactions could be traced back to dishonestly defaulting UK traders who had failed to account for output tax. They further allege that the transactions with the appellant referred to above were used by Starmill to create output tax liabilities with a view to disguising or avoiding enquiries about the alleged involvement with fraudulent chains of transactions, or to give a false sense that Starmill was a legitimate trader should enquiries be made, or to provide liquidity for Starmill's dishonest trading; or a combination of those purposes.

47. The appellant has put the respondents to proof of the dishonesty of the alleged defaulting traders and so we will make findings about them before dealing with the evidence about Starmill itself.

48. The first defaulter is GPA International Limited (GPA). Officers Archibald, Bennett and Silvester gave evidence about it. In June 2004 GPA registered for VAT as an off-licence in Macclesfield and made returns showing modest trading up to 03/05. It then made two nil returns and rendered a return showing £2,460 due for 12/05 which it did not pay. Thereafter no returns were made but it came to HMRC's attention, through enquiries at a freight forwarding company, that GPA was trading in phones and computer parts. HMRC then visited the premises at which GPA were supposed to be based but found them to be closed and shutters drawn across the windows. HMRC therefore almost immediately issued a notice, under their statutory powers, requiring GPA to make a return forthwith which elicited no response and the respondents have since then been unable to make any significant contact with the company or its officers despite several attempts. Evidence of transactions gathered from third parties showed that GPA should have accounted for output tax of at least £13,115,390, which was neither declared nor paid. The amount of output tax unaccounted for by GPA in twenty deal chains in which goods sold by GPA were subsequently dispatched or exported by Starmill in April 2006 was £2,629,863.43. Those sales were not directly to Starmill but the transactions can be traced through other parties from GPA to Starmill.

49. We have no hesitation in finding that GPA defaulted in its payment of VAT, so much is indisputable, and if it is not sufficient to prove dishonesty that the enormous sum in question was built up over a very short period, then the facts that the company failed even to make its returns and then, when enquiries began, its officers disappeared; is more than enough to prove that the default was dishonest and we so find.

50. The second defaulter is prestige 29 UK Limited (Prestige). Officer Archibald gave evidence about Prestige and we find the facts are as follows. Prestige registered for VAT in June 2005 as a kitchen and bathroom supplier with an expected turnover

of £140,000 per annum. HMRC officers had reason to visit the company's premises on 10 May 2006 and found them to be disused. As a result, a notice to render an immediate return was issued and the failure to do so led to the company being de-registered with effect from 10 May 2006. The company had failed to make any returns after November 2005. It had been involved in a single transaction relevant to this appeal when, in April 2006, it had sold goods on which an output tax liability of £654,622.50 arose and which should have been accounted for on the return directed to be made for the period ending 10 May 2006. Those goods formed part of a chain leading to Starmill which sold them under a zero rated supply and for which Starmill claimed input tax on the purchase. Starmill had not purchased those goods directly from Prestige.

51. We are satisfied on the evidence and find that Prestige defaulted in its payment of VAT. The company had simply disappeared from its premises and had failed to make returns while trading on a large scale (the single transaction leading to Starmill's export was worth £4,395,322.50, tax inclusive). We find that those facts prove to our satisfaction that the default was dishonest.

52. The third defaulter is The Taxable Person Purporting To Be KEP 2004 Ltd (TPPTB KEP). That means that the commissioners allege that an unknown person was using the identity of KEP 2004 Ltd but that the evidence suggests that it was not KEP 2004 Ltd itself that was trading. This is known as a hi-jacked company in the jargon adopted in this type of appeal. In fact, as became clear from officer Archibald's evidence the situation is somewhat unclear. KEP 2004 Ltd was a genuine company and it traded as a supplier of labour in the construction industry. Its director (we will not name him here as nothing has been proved against him) was a project manager at a large construction site and the company undoubtedly had a legitimate business and was registered for VAT and was making returns.

53. The director of KEP 2004 Ltd was interviewed by HMRC officers when it appeared from evidence obtained from third parties that the company had traded on a large scale in phones and computer equipment. The director explained that he had had some negotiations about becoming some kind of agent for acquisition from Germany of such goods and their onward sale in the UK and that he received some paperwork from one of the parties he was negotiating with and signed some release notes in KEP 24 Ltd's name.

54. Either KEP 24 Ltd or TTPPTB KEP was involved, in the period beginning March 2006, in transactions worth approximately £672,000,000 (tax inclusive) and had a tax debt of approximately £101,000,000. One transaction or group of transactions in April 2006, which involved several separate invoices, was in a chain leading to Starmill, though neither of the two possible KEP entities was Starmill's direct supplier. That transaction involved output tax payable by one or other of the KEP entities in the sum of £8,646,469.

55. Clearly any person or body trading on that scale would have been liable to register for VAT so that whether the true facts were that KEP 2004 Ltd or TTPPTB KEP was the relevant party there was a default on a scale that itself is sufficient to

prove dishonesty. Added to that, either the director of KEP 2004 Ltd then deliberately lied to HMRC when the officers made enquiries (which would be further proof of dishonesty) or the unknown person using that name, by using it, acted dishonestly. We have no hesitation in finding that the KEP transactions were dishonest defaults despite the full facts being unknown.

56. The fourth defaulter is UK Communication Ltd (UKC). Mr Archibald also gave evidence about UKC. That company had traded in a small way from its registration in September 2005 until, as the director told a visiting officer, it had branched out into wholesaling phones and CPUs. The company issued invoices which did not show its VAT number and, when asked for documents by HMRC, failed to produce them. What is known about the company was discovered from its customers' records. The company owes HMRC £34,227,178 by way of unpaid VAT which represents a turnover of nearly £230,000,000. The director of the company was unable to spell its name correctly thinking its name was UK Communications Ltd. The huge increase in turnover over a short period and the enormous debt to HMRC are themselves indicative of fraud and, if more proof were needed, the failure to produce records and the incorrect sales invoices, we find, amply prove that the company's default is dishonest.

57. The UKC transactions which were in chains leading to Starmill involved output tax of £5,580,730 which UKC should have declared.

58. All the defaulters in question were therefore dishonest and the output tax on sales by them for which defaults have been proved in respect of sales which found their way to Starmill in April 2006 is over £17,000,000. We now turn to the evidence about Starmill itself.

59. Starmill registered for VAT in January 2003 and traded modestly for two years and then in the year ending November 2005 it traded hardly at all having declared outputs of £1,731 and making a number of consecutive nil returns for VAT. In its monthly return for 03/06 it declared outputs of £28,608,754 and inputs of £28,187,214 and claimed a repayment of £303,172. In its return for 04/06 it declared outputs of £53,452,903, inputs of £54,314,983 and a repayment of £897,023. In 05/06 Starmill's trade was down to a turnover of £5,000,000 and it effectively ceased to trade in the following month.

60. Starmill was well aware of the existence of MTIC fraud from visits and correspondence from HMRC officers.

61. Starmill carried out due diligence checks on parties with which it traded through a business called CTM. The evidence shows however that on several occasions Starmill did not wait for the replies from CTM before trading with those counterparties. That applied to Starmill's trading with the appellant. If Starmill thought the CTM reports were necessary it would surely have been expected to await them before dealing with the persons to be reported on. The deals in question related to large sums. Not having waited is, we find, indicative of one or both of two things, either Starmill was only obtaining the reports as a means to deceive HMRC into

thinking it was a careful trader and/or it somehow knew that it could safely trade with those counterparties despite having what would have appeared to a prudent person to be inadequate knowledge of them.

62. The willingness to trade without adequate prior enquiry was particularly significant because the transactions were conducted on terms which appear entirely inadequate, especially given the values involved, having been conducted without written agreements. The transactions themselves were conducted between a number of parties within single days and none of the parties held goods in stock or had to split or amalgamate consignments to find suppliers or satisfy purchasers. Parcels of goods passed between a number of parties without alteration and without any of the parties having taken possession of them.

63. When Starmill acted as a broker it achieved considerably better mark ups than when it acted as a supplier in a sale to another UK trader. This was a remarkably consistent feature of the company's business and calls into question why it should ever have conducted sales in the UK when it appeared to be able to make better returns on sales to overseas buyers. It is at least highly probable that the reason was that the company wanted to avoid making too large an input tax reclaim and so was very keen to have output transactions which would disguise its true intentions. As we have already noted, it is in fact the case that it did make fairly substantial repayment claims but the claims would have been enormous had the company not engaged in the less profitable UK sales which gave rise to output tax liabilities.

64. The commissioners have obtained evidence from the First Curacao International Bank (FCIB) used by most if not all of the parties in the transaction chains that feature in this case. It is time consuming for the commissioners to trace transactions through the various accounts but it can be done and they have traced a sample of transactions relating to Starmill. Officer Simmons set out to trace three of the transactions in which Starmill sold goods to the appellant. In all the three cases for which he did trace the payments he found that large sums passed from 2Trade to the appellant which paid Starmill which paid Global. Those payments were to be expected as they were the parties to the transactions. More surprising is the fact that Global then paid significant sums to Piperno Ltd of Cyprus which paid Komidex Spolka Z Orgraniczona of Poland which paid a large sum to 2Trade. Those payments were all made on the same day and, as far as can be judged from the FCIB transaction numbers, within a short time and all in sterling. Of the £627,000 paid by 2Trade to the appellant 2Trade received an immediate repayment of £400,000 from Komidex, that money having gone round in a circle almost instantaneously.

65. Exactly the same pattern applied to all three of the deals that were traced and in some cases the parties involved in passing the money round paid out exactly what they had received so it is clear that the payments are unlikely to have related to sales of goods as no mark up had been made and indeed allowing for bank charges those companies had made a small loss.

66. Two of Starmill's broker deals were also examined. In both cases the chain of supply of the goods was from GPA International to Chatterbox Communications Ltd

to Starmill which sold them to CZ International. A large part of the money in question went round a circle from and back to Starmill. The circle involved PPUH Kumar of Poland and Yapsley Trading of Spain as well as the parties that had been involved in the sales of the goods. In stead of GPA receiving a payment the payment was made to the company secretary of GPA Mr Raja Amanulla. When the money was paid to Yapsley that company paid some of it to PPUH and it went back to Starmill via that company and CZ but some was paid to Komidex which paid it to 2Trade which paid it to Purple Telecom Limited which was associated with the appellant by reason of the fact that Mr Wager owned that company.

67. The evidence of Mr Simmons was closely examined in cross examination. In respect of all the transactions examined there is an element of judgment involved in the conclusion that the money flowed in a circle. Moneys paid into an account are in any event fungible so that it can be said that any payment loses its identity as soon as it is paid-in but in practice, where a payment into an account is immediately followed by a payment-out of an identical or nearly identical sum, especially if the paying party would not have been able to make the payment-out without having received the payment- in, it is entirely reasonable to say that the money has moved in a circle if a number of payments lead back to the starting point. The circularity is further proven where the payments are made immediately or nearly immediately as shown by the transaction numbers on the various accounts. The situation is less clear where the amount of money paid out is significantly different from a payment-in which the Commissioners seek to associate with each other. Some of the allegedly circular transactions were of that sort. Having considered very carefully the evidence relating to all the transactions which had been examined we are satisfied that the evidence does justify a conclusion that the money was circulated in the relevant sense, although we acknowledge that the evidence is stronger in some cases than others. The skill and detail of Mr Patchett-Joyce's cross examination did not reveal a transaction for which the evidence failed to prove the alleged circularity. The general remarks in this paragraph are applicable to all the alleged circular transactions in this case not just those relating to Starmill transactions and we will not repeat them for all the chains examined.

68. We should note immediately that these circular flows of money do not prove anything against the appellant because it has not been proved that the appellant knew of them. However, in answering the question whether there was a connexion between the appellant's transactions and the dirty chain transactions of Starmill and whether Starmill was acting dishonestly as a contra-trader these circular flows of money are significant. They prove that there was a contrived and planned connection between transactions.

69. They are also evidence relevant to answering the question whether or not the appellant's transactions were in fact connected with the dirty chain transactions; whether the appellant knew it or not.

70. The payments made by the appellant to Starmill were available to Starmill to enable it to engage in the dirty chain transactions. The contrived nature of those dirty chain transactions is demonstrated by the circularity of payments which is further

evidence of the dishonesty involved in them. The appellant had to fund only part of its payments for the goods from its own resources because it received payment of the tax exclusive value from its customer before it had to pay its supplier the tax inclusive price. But it would have been reimbursed by the Commissioners by way of input tax repayments if they had not refused the claims. There is therefore a connection between the clean and dirty chain transactions, because the clean chain transactions made available additional money to Starmill for it to finance the dirty chain transactions. Starmill's desire for that money no doubt provides an explanation of why it was prepared to enter into those transactions in addition to the desire to disguise the level of its input tax claims.

71. On the facts set out in the above paragraphs we are satisfied, and find, that Starmill engaged in the transactions with the appellant as a contra-trader and did so dishonestly.

Alleged contra-trader HKS Trading Ltd (HKS).

72. Having set out the full details of the transactions with Starmill we propose to deal with the other alleged contra-traders in somewhat less detail so far as the transactions between the appellant and the other contra-traders are concerned.

73. In these transactions it is alleged that HKS were the contra-trader but the appellant did not buy the relevant goods directly from HKS. The transactions all occurred on 28 April 2006. The appellant bought goods which HKS had sold to Churchill International Trading Ltd which sold them on to the appellant. There were 25,000 units. The three deals had identical parties at each stage in the chain. The total value of the goods the appellant sold to its Canadian customer was £2,011,500. HKS achieved a mark up of 50p per unit as did Churchill and the appellant achieved an average mark up of £5.26 per unit.

74. Although the sales to the appellant preceded the alleged dirty chain transactions the offsetting of output tax against the dirty chain input tax by HKS fell within its three month tax period which included April 2006 and so the appellant's transactions in fact had the effect of offsetting input tax claimed in HKS's alleged dirty chains. That output tax had been incurred in sales made to Churchill rather than directly to the appellant. However it was the appellant that exported the goods to Canada and at the time of export it therefore made zero-rated sales and provided additional finance pending the recovery of input tax in the same manner as described above. Whether there is a connection between two transactions is a question of fact and we find that there was a connection between the appellant's purchases from Churchill and the defaults in the dirty chains. That connection consisted of the fact that by buying goods from Churchill, which had bought them from HKS, the appellant had in fact enabled HKS to disguise the fact of the size of its input tax claims, and had provided liquidity to the chain and provided HKS with a semblance of legitimate trading, assuming some of its trading was in fact other than legitimate. We will consider whether HKS's trading was legitimate or whether, as HMRC allege, that company had engaged in dirty chain transactions as a contra-trader. It is appropriate to decide first whether the defaulters in the alleged dirty chains had been dishonest.

75. The first defaulter to consider is West 1 Facilities Management Ltd (West 1). Officer Fu Sang Lam gave evidence about this company. It registered for VAT from 21 August 2001 and traded as a service provider. It made modest returns including a number of nil returns between 09/00 and 09/05, the last of those having declared outputs of £4,800 resulting in a payment of tax of £551.68. In the following periods outputs were declared as follows: 12/05 £61,883,305 (payment to HMRC £5,708) and 03/06 £372,943,012 (repayment claimed £164,665). HMRC subsequently amended the 03/06 period to a turnover of £690,779,109 with £48,931,165 payable. The 06/06 period was curtailed by a statutory notice and West 1 was required to make a return for the period ending 20 June 2006 which it failed to do and in that period HMRC calculated the outputs to be valued at £810,950,791.

76. West 1 failed to keep proper records or to produce them when requested and operated from premises which were absurdly inadequate for a business with a turnover approaching two billion pounds a year. It moved its office without informing HMRC and when enquiries were made and led to the issue of the statutory notice the company simply went missing. Unless some explanation of how the company managed to build up such a level of trade in such a short time is forthcoming, which it is not, that in itself is highly indicative of fraud and the evidence also shows that many of the deals transacted by the company led back to fraudulent traders. Most of the company's acquisition deals had been omitted from the return for 03/06 and the huge correction that had to be made by HMRC is yet further evidence of fraud. We find that West 1 was operated fraudulently and that the defaults in the chains leading to HKS were fraudulent.

77. The other alleged defaulter in the alleged HKS dirty chains is Roble Comm Ltd. (Roble). That company had supplied 5,888 units in two supply chains leading to HKS in March 2006. The total value of the goods sold by Roble Comm in those transactions was £1,103,484.80 and Roble achieved a mark up of 50p per unit.

78. Roble was successor, by way of a transfer of a going concern, from a sole proprietor and retained that proprietor's VAT number. Enquiries relevant to this appeal were made by Officer Lamb and began with a visit to the appellant's registered address which turned out to be the premises of an internet café which was being used only as a post box by Roble. The officer issued an immediate notice cancelling the registration which elicited a response from a director who complained that persons wishing to deal with Roble were unable to verify the VAT number.

79. At a subsequent meeting the director admitted that all payments to Roble were made to a third party and that Roble received what she termed a commission. She also said that she had not previously been involved in transactions of the type in question and had not sought any customers or suppliers both of which simply contacted her shortly before any transaction was to take place. In effect it is clear that Roble was being used purely as a 'front' for other parties.

80. Sales valued at £103,309,500 plus VAT of £18,079,162.50 had been made in a nine day period all of which had been supplied to Roble by Lodgeway Consultants Ltd. Roble also purportedly made sales to an Italian company which turned out to be

a hi-jacked company and claimed that the input tax on those sales offset its output tax liabilities but no satisfactory evidence was produced that the sales to Italy had ever occurred at all and certainly they had not been made to the purported purchaser.

81. Roble was ultimately assessed for more than £24 million.

82. We have no doubt, and find, that Roble was a defaulter in the chains leading to HKS and was dishonest.

83. We turn to the evidence about HKS itself. Deals with West 1 as a defaulter totalled £3,310,387 of VAT and with Roble £164,864.

84. In the three deals on 28 April 2006 in which HKS sold goods to Churchill which sold on to the appellant the mark ups achieved by Churchill and HKS were 50p per unit (in total 25,000 units). The appellant's mark up on sales to the Canadian buyer were £6.10 per unit (two deals with a total of 15,000 units) and £4.00 per unit (one deal of 10,000 units) for the two types of goods sold.

85. HKS registered for VAT with effect from 9 September 2005 and stated that its intended business would be selling household and electrical goods and that it intended to expand into telecommunications though that was in the context of selling Vodafone contracts. A nil turnover was declared in the return for November 2005. By the three month period ending 02/06 HKS's turnover had reached £60,532,250 net in sales and £60,433,650 net in purchases. Its output and input tax matched very closely and it paid £6,021.17. In the 05/06 period its net sales were £206,720,196 and net inputs were £208,698,428 and it claimed a refund of £346,340 which was made the subject of extended verification. Those were the figures on the return before it was corrected. The true position in the company's records should have been declared as a relatively small payment due to HMRC. The increase in trade in 02/06 and 05/06 was not as a result of selling Vodafone contracts but was in wholesale transactions.

86. That increase in turnover is itself evidence of fraud because of its size and because it was not declared at the time of registration that such would be the type of trade. It is true that a trader can change its mind about what type of trade it will engage in. But this was a newly registered company which had stated it would engage in a different type of trade and therefore, unless it was lying to the authorities at the time of registration, it had not then even begun to think about going into the type of trade it in fact entered. That it could build up to such a level so quickly is incredible in normal circumstances and that it did so is indicative of there being a false market which it must have willingly entered.

87. HKS was unable to produce documents asked for by HMRC, had not insured the goods it dealt with in most cases and had not inspected the goods in most of its transactions. It had carried out inadequate due diligence enquiries about some of the parties with which it dealt.

88. The failure to inspect is particularly significant in light of the very high values involved in the transactions. For any company to engage in goods of such value without taking physical possession of the goods or having them inspected is very

unusual in ordinary commercial terms and its willingness to do so suggests that it had a degree of confidence that the goods would be paid for which bears little relationship to normal commercial realities. That it was also willing to carry out these transactions without even insuring the goods is an additional reason to suspect a perceived lack of concern about what would have been elements of risk that would normally be guarded against.

89. The deals were significantly clustered at the ends of months or its own tax periods and there was a pattern to the deals with more of those giving rise to input tax claims and those incurring output tax liabilities clustered together in a way that was not likely to occur in normal trading but did enable the company the better to balance its liabilities. It is true that in the tax period relevant to this appeal HKS did claim a significant repayment but we do not regard that as sufficient reason to ignore the other indications of contrived trading.

90. The director of the company transferred effective ownership of it to a new director without having agreed a sale price but the new director said he expected to pay between £20,000 and £30,000. That transfer took place while the repayment claim for £346,340 was still being pursued.

91. The commercial unreality of the company's trade and the manner in which it was operated leads us to find that the company was operated dishonestly. We also find that it entered into the relevant transactions with the appellant in an effort to disguise the level of its illegitimate input tax claims and that the payments made by the appellant provided liquidity for HKS's trading and so its transactions with the appellant were in fact connected with the fraudulent trading.

Alleged contra-trader DB Computers Ltd (DB).

92. The appellant bought goods directly from DB in six transactions in May 2006 and two more transactions in that month in which a company called Grade One Trading had bought goods from DB and sold them immediately to the appellant. All but one of the transactions led to the appellant selling the goods on 31 May to EU buyers and the exception was a sale on 1 June also to an EU buyer. Most of the sales to the appellant were also on 31 May and those that were not were within a day or two before that date. The net value of the appellant's purchases was £5,429,200 and the appellant claimed £950,110 as input tax. Matrix achieved an average mark up of £7.14 for the 49,800 units involved whereas its suppliers (DB or Grade One) achieved an average of 38p and in the deals where Grade One stood between DB and the appellant DB made only 20p per unit.

93. DB are the alleged contra-trader and the alleged dirty chains in its 06/06 period led back to defaulting traders Heathrow Business Solutions Limited (Heathrow) and TTPPTB Belling. Both of those defaulting traders can be dealt with briefly so far as the evidence is concerned. The undisputed facts are that both those traders were in fact using false addresses. Heathrow made nil returns of tax despite having a turnover which led to its being assessed for £31,607,310 which it has not disputed. TTPPTB Belling was using the name of the well known manufacturer of electrical goods

though the real company of that name was dormant and the goods' manufacture is now by other members of the group. The false Belling gave a council house as its address and has been assessed for £28,595,806.

94. Mr Patchett-Joyce cross examined officers Lewis, Arnold and Foy about those defaulting traders but the questioning did not contest the fact that they were dishonest defaulters but rather probed HMRC's response to them with the intention of bringing out the fact that no evidence exists to show that the appellant knew of or had dealings with those companies.

95. Turning to DB itself, the evidence was mostly that of officer Foy. DB registered for VAT in August 2003 having stated in its application to register that it intended to buy and sell computer equipment to other businesses. It traded in modest amounts up to and including 12/05 when its outputs were £28,328. In the next period (03/06) it had started to deal in back to back deals in large scale transactions and its outputs rose to £2,043,725. In 06/06 its outputs rose to £19,141,296. For 06/06 it submitted a repayment claim for £27,513.67 that was largely a result of DB having a claim for £1,128,933.75 by way of input tax on goods bought from the chains in which the missing or hi-jacked defaulters already referred to had been involved and in respect of which DB exported the goods but also as a result of clean chain deals involving the appellant (including the two which were via Grade One) which had largely off-set the very large input tax claim that would otherwise have been the case.

96. During the 06/06 period the trading of DB showed a pattern that appears significant. All but one of its first nine deals in that period gave rise to large output tax liabilities. Its subsequent deals in that period, which numbered four, gave rise to most of the large input tax claim already referred to. Whilst it is certainly possible for normal trading to throw up such a pattern we find it to be very unlikely especially as the input tax and output tax involved are such large amounts. There is also a reasonably marked difference in the mark up achieved by DB when it exported goods and when it sold directly to the appellant or to Grade One. The export transactions showed a higher mark up.

97. We find that the evidence shows that DB carried out very limited due diligence checks on its suppliers and customers and that much of it was carried out after the deals had been done. Those facts suggest that DB knew that the deals would be completed satisfactorily because of something inherent in the deals themselves and although that might have been because of their back to back nature we are not satisfied that that is a sufficient explanation as there must have been risks in shipping goods to and buying them from parties about which DB knew little. In addition DB was unable to produce evidence that it had insured the goods which is a significant fact in light of the high values involved. No written contracts were in place which we also consider significant.

98. Three of DB's deals with the appellant have been traced in the FCIB records and in all three there is circulation of money of the type already referred to. Two different purchasers from the appellant feature in these transactions. In one case Matrix had sold goods to African Networks BV (of the Netherlands) and in two it had sold to

Mona SA (of Luxembourg). The circulation of money passed through identical parties in all three cases including one each in Poland, Spain, Romania and Turkey. Only African Networks and Mona differ in the circulation of the money. It is impossible to avoid the conclusion that someone had contrived the payments of money all of which occurred in a short period of time and so there was certainly a fraudulent motive for the clean chain transactions on the part of someone. In addition one of the transactions in which Grade One had bought goods from DB and sold on to the appellant also showed a circular flow of funds albeit in that case through numerous parties that were not identical to those involved in the sales directly from DB to the appellant. Some of those numerous parties were ones that also appeared in the three transactions already referred to. In that single chain DB's supplier (ICC of Spain) was apparently not paid at all for the goods as the circularity of funds by-passed it altogether.

99. We find that the transactions between the appellant and DB, including those indirectly between those parties via Grade One, were contrived and dishonest and were fraudulent transactions. We also find that DB deliberately and dishonestly manipulated its trading so as to disguise the extent of its input tax claims and so as to attempt to avoid HMRC enquiring too closely into its claim. In respect of that last point DB succeeded because although HMRC began an in depth investigation that was abandoned because there were too many bigger claims for the officers to enquire into at the relevant time.

Alleged contra-trader Peach Data Services Plc (Peach).

100. The appellant was involved in two clean chain transactions in which it purchased goods from Peach which that company had imported from the same French supplier and which the appellant exported to Cayenne Trading (Cayenne) of Luxembourg. The appellant's achieved mark up was £21 for 950 units sold by it at £425 each and £84 for 1,000 units sold by it at £1,404 each. Peach achieved a mark up of £2 on each of the 1,950 units despite the large difference in price of the goods in the two deals.

101. Dirty chain transactions in which Peach was involved led back to a defaulting trader called DBP Trading Ltd (DBP). DBP were also an alleged defaulting trader for another alleged contra-trader (Computer Components Marketing plc - CCM) and we deal with the reasons why we find DBP to be a dishonest defaulter under the CCM evidence below.

102. Peach itself registered for VAT on 1 April 1987 and declared its expected turnover would be £250,000 per annum as a computer services supplier. In the year ending 30 September 2004 its turnover was £575,000. In the year ending 30 September 2005 trade continued at a similar level until the last three months when sales jumped to £13,516,000 on the introduction of transactions relating to goods as opposed to services. Trade continued at that high level in the first nine months of the next accounting year reaching over £25,000,000 after which there was a marked drop in turnover. Peach ceased to make returns after the 12/06 quarter.

103. The transactions between the appellant and Peach were in May 2006 which fell within Peach's 06/06 period. In that period Peach carried out 14 transactions giving rise to an output tax liability of £1,823,465.74 and an input tax entitlement of £1,824,850.05. Of those 14 transactions two were acquisitions from an EU supplier which Peach sold to the appellant, 11 were purchases from UK suppliers and sales to UK customers and one was a purchase from a UK supplier and a dispatch to an EU customer.

104. We have already noted that Peach achieved a consistent small mark up of £2 per unit in marked contrast to the large and distinctly different mark up achieved by the appellant in the two deals in which the appellant purchased goods from Peach. The appellant sold those goods to Cayenne Trading SA (Cayenne) of Luxembourg. The evidence of officer Mould, who dealt with Peach, shows that there was a close connection between Peach and Cayenne through a Mr Gromer who was the director of Peach and the company secretary of Cayenne. It is remarkable that Peach should sell goods to the appellant at a low mark up which the appellant was then able to sell at a large mark up to a company with which Peach had such a connection. In all eleven of the UK supplier to UK customer deals Peach achieved a mark up of exactly 25 pence per unit despite the goods and the quantities being varied.

105. Peach failed to produce documents to HMRC when requested.

106. The FCIB evidence shows that Cayenne had been able to pay the appellant in respect of one of the two relevant transactions with funds which appear to have been provided to Cayenne from Andrevias of Romania via Mighty Mobile of the British Virgin Islands. The money paid by the appellant to Peach then circulated back to Andrevias.

107. The evidence that Peach knew about MTIC fraud is compelling. Not only was there evidence that it had been visited by officers but also that through a network of common or associated directors Peach was associated with several companies that had been involved in MTIC fraud.

108. We have no hesitation in finding that Peach's transactions with the appellant were fraudulent and were part of an overall fraudulent scheme with which the appellant's transactions were connected as having been used to disguise the size of the input tax claim being made within the fraud and to provide funds for the furtherance of the scheme by way of the appellant's having funded input tax pending its recovery, as previously described.

Alleged contra-trader Signal Telecom limited (Signal).

109. The appellant bought goods from Signal in two deals in April and three deals in May 2006 all of which were sold on by the appellant to Universal Transolutions Group SL trading as Logout (Logout). Signal achieved mark ups of between 45 pence and £1 per unit on its sales to the appellant and the appellant achieved mark ups of between £11.40 and £8.90.

110. The respondents rely upon evidence about three defaulting traders in chains of supply in which Signal was involved.

111. The first is DBP Trading Limited (DBP). Officer Alistair Strachan gave evidence about that company. That company registered for VAT as a building repair company and had a small turnover until June 2005 when it changed its address and started to deal in electrical goods, a business in which the director had no experience and which he claimed to have started after a chance meeting in a night club. In the period 08/05 its turnover was over £16,000,000. HMRC visits made the director aware of MTIC fraud and the undesirability of third party payments but the company continued to make third party payments.

112. On a visit by an officer in June 2006 no-one was on DBP's premises and a neighbour said they were seldom occupied. Shortly afterwards officers met the company's accountant who said that the return for 05/06 on which he was then working would have a declared turnover of about £330,000,000. That return was not rendered and an assessment for £46,361,806 was issued which remains unpaid and the director has disappeared.

113. We find that those facts are sufficient to prove that DBP's default was dishonest.

114. The next defaulting trader is GPA International Limited (GPA). That company was registered as an off-licence and drinks wholesaler from 15 July 2004 with a declared expected turnover of £250,000 per annum. On discovering that the company was trading in mobile phones an officer visited its premises but finding no-one there he left a direction to make a return forthwith and shortly after that he de-registered the company when it failed to make the return and notified the company of that fact. That elicited a response from the director who said he did not want the company to be de-registered at any cost. The officer told him that the de-registration would not be reversed and after that there was no further contact from the director. GPA has been assessed for £13,227,991.99 but has neither disputed nor paid that amount.

115. We find that GPA's default was dishonest.

116. The third defaulter relied upon by the respondents is Prompt Info Limited (Prompt). That company registered as a software development and consultancy business but went missing from its premises and was de-registered as a missing trader with effect from 7 February 2006. On 26 May 2006 it contacted HMRC requesting to have its registration re-instated which was refused. Prompt has continued to trade despite its de-registration but has not appealed against the de-registration and currently owes HMRC £22,187,189.

117. We find that Prompt's default was dishonest.

118. Signal itself was registered initially as a payroll bureau service operated by the partners in a firm of accountants. The accountants were replaced as directors in April 2002 and the company changed its name to its present one. By 05/02 it had commenced to trade in mobile phones.

119. In 2006 Signal was making monthly returns and its turnover and tax liability was as follows. In 03/06, in round terms, on a turnover of £86,000,000 it paid £49,000 tax. In 04/06 it paid £41,154.90 on a turnover of £44,319,355. In 05/06 it paid £41,907.60 on a turnover of £81,396,366. EC supplies and acquisitions were amounts which nearly balanced each other especially in 05/06 when EU supplies exceeded acquisitions by only £196,035 even though the supplies totalled £39,737,080. Those figures suggest contrivance in themselves. All the acquisition deals for 04/06 and 05/06, of which there were 91, were supplies received from the Atlantic IT Factory or Stankom and all the goods from those deals were sold to either the appellant or one other broker who then sold them to EU customers.

120. Three of Signal's sales to the appellant have been shown to involve circular payments all of which involve the same two Belgian and Czech entities and two of which in addition involve a Portuguese entity.

121. The evidence for Signal being involved in contrived trading which is itself suggestive of dishonesty is strong.

122. Signal was well aware of the existence of MTIC fraud as is shown by evidence of visits from officers and correspondence.

123. When Signal sold goods to other EU customers it consistently made a much lower mark up than the one the appellant was able to achieve for similar deals. That indicates that Signal, which was a very large and in that sense a successful business, must have had a motive to sell the goods to the EU at a price less than it might otherwise have achieved for some motive other than to maximise its profit on those deals and HMRC contends that its motive was to balance inputs and outputs for the purpose of disguising the size of its input tax claims in the fraudulent chains.

124. On the above evidence we would have been prepared to find that Signal was a dishonest contra-trader but in addition to that evidence it is a fact that the director of the holding company which owns the shares in Signal was found guilty of cheating the public revenue and was sentenced to 10 years and six months in prison and its company secretary was sentenced to 12 years and six months for carousel fraud. The shareholder in the holding company lives at the same address as the director of Signal and all the persons mentioned appear to be members of the same family. In addition, the director of the Atlantic IT Factory which supplied Signal was also sentenced to 7 years and six months for the same carousel fraud.

125. We find that Signal was dishonestly involved in contra trading with a view to facilitating the fraud which involved the defaulting traders and that the transactions with the appellant were connected with that fraud as transactions that helped to disguise the fraud in the way we have already described and or to provide funds for the furtherance of that fraud by financing the tax output tax payable until the recovery of input tax could be achieved.

Alleged contra-trader Computer Components Marketing Plc (CCM).

126. The appellant bought goods from CCM on six occasions relevant to this appeal, three in April and three in May. On three of those occasions CCM purchased the goods by way of an acquisition from Atlantic IT factory and on three from Stankom Trading GMBH. In each of the April deals CCM achieved a mark up of 75 pence despite buying from two different suppliers and different types and quantities of goods which had different values. In each of the May deals CCM achieved a mark up of £1 despite the same facts applying to those deals.

127. The allegation against CCM is that it was a contra-trader in chains leading back to five dishonest defaulting traders. Two of them have already been dealt with, namely GPA and DBP as to which see above.

128. Four deals conducted by CCM in April were alleged by DBP to have been sourced from a company called 1st 4 Report Limited. Such a company did exist but on enquiry by HMRC that company denied that it had supplied the goods in question. DBP had a number of 1st 4 Report invoices in its records for various dates between March and June 2006 totalling nearly £11,000,000 including some of those alleged to have been purchased by CCM. As there was no proof of who made those supplies an assessment was raised against the Taxable Person Purporting To Be 1st 4 Reports Limited which, naturally, remains unpaid. Clearly whoever that person was is a dishonest defaulter having either hi-jacked that company's name or lied about being the supplier.

129. UK Wide Computers Ltd (UKW) supplied CCM in April and May 2006 but made no VAT return and produced no records which would have enabled HMRC to trace the goods back to a source. UKW were in default for failing to make returns and even if that company was only a blocking trader rather than the defaulter directly causing a tax loss we are satisfied that there was a tax loss in the chains relating to UKW because UKW had dealt with proven defaulters in respect of many other transactions. On the balance of probabilities we are satisfied that those transactions for which no direct evidence is available did lead back to dishonest defaults because of the circumstances that UKW refused to produce its records and has been shown to have dealt with defaulters or to be engaged in default chains on other occasions.

130. Four of CCM's deals in the relevant period trace back to a company called Advertising South Limited (AS) which registered for VAT in June 2005 as an advertising agency. Enquiries by HMRC have not been able to establish with certainty whether that company actual made any of the supplies in those chains. The director of the company has denied that it did so but some evidence suggests that it may have been involved because, for instance, other parties in the chains had details which they must have received from the director such as a copy of his passport. However, the evidence is quite clear that if AS did make the supplies in question it did so dishonestly as it has not accounted for VAT thus creating a default but if it did not make the supplies and its name was used by another person then that would in itself be a default and would clearly be dishonest.

131. Turning to CCM itself it had had a total turnover of £23,828,708 in the three years ending June 2005. In 09/05 the turnover jumped to £38,008,370 then to

£77,376,451 in 03/06 and £126,313,588 in 06/06. Despite making highly profitable sales of great value to EU customers in 06/06 the company also made marginally profitable sales to UK customers in the same period selling goods which on the face of it should have been able to generate valuable profits similar to the other transactions had the EU customers been supplied. The two types of sales were clustered together at different times so as to suggest that the company had deliberately engaged in such trading so as to offset the input tax it would reclaim against output tax due as a result of the barely profitable deals. When challenged the company failed to provide documents to support its trading and its shareholder and director went missing. We are satisfied that CCM was fraudulently engaged in deliberate contra-trading with a view to defrauding the revenue.

Alleged contra-trader Prime Commodities UK Limited (Prime).

132. The appellant purchased two parcels of goods from Prime in May 2006. Prime achieved a mark up of £1 per unit for both deals whereas the appellant achieved £8.60 and £17.20 respectively.

133. The respondents allege that the transactions led back to a defaulting trader called Universal Supplies Ltd which traded as Easiblaster (Easiblaster). The default which Easiblaster caused was what is termed a blocking trader default. That means that, although Easiblaster may not have been the party in the chain of transactions which was the primary cause of loss to the revenue, its actions prevented HMRC from tracing who that defaulting party was. The respondents also contend that the evidence shows that on a balance of probabilities they can prove there was a default in the normal sense albeit that they cannot prove which entity was directly responsible for it.

134. Easibalster was registered for VAT in 1982 and had a turnover of approximately £300,000 a year until a change of directors led to an increase in turnover in period 05/05 in which the turnover was £1,456,770. In 03/06 the turnover peaked at £98,652,454. In 06/06 which is the relevant period for this appeal the turnover was £5,245,658. Officers asked for records relating to that period and none were produced which led to an assessment of £2,252,496 consisting of disallowed input tax as a result of Easiblaster’s failure to prove that the purchases had occurred or at least that they were taxable supplies.

135. The evidence of officer Launder was that 90% of Easiblaster’s known purchases traced back to known defaulters and so we were invited to find that the transactions in question, on a balance of probabilities, also would have been in chains tracing back to defaulters.

136. In addition to that evidence we also have the evidence relating to Prime itself. Prime had reclaimed VAT in all its VAT periods from 10/04 until 04/06. In period 07/06 it only traded in May and an administrator was appointed on 27 July. In the last four days of May Prime made sales valued at £11,327,189 and had purchases valued at £11,287,423. The May trading was a departure from its usual trading as there were also acquisitions as well as dispatches and the balance between the two together with the output and input tax on UK purchases and sales gave rise to a liability of £6,817.

Without the dispatch transactions the liability would have been higher. The alteration in the company's trading pattern enabled it to disguise what would otherwise have been a large repayment claim.

137. The £6,817 was not paid.

138. Prime started to trade with no capital but achieved a turnover of £2,520,000 in its first four months of trading and very much more in later periods. Between September 2005 and May 2006 Prime conducted business worth £73,000,000 with Easiblaster despite having carried out no credit checks or made any visits to that company (or at least having been unable to produce any records to show that it had done so).

139. One of Prime's transactions with the appellant was shown to have been the subject of a circulation of funds through the FCIB bank.

140. We find that Prime was dishonestly involved in a scheme to disguise the defaults of others in the chains of transactions in which it was involved including the two which involved the appellant. The evidence shows that the involvement of Prime was part of a contrived scheme to defraud the revenue and that in itself strengthens the evidence for a finding that Easiblaster was also involved in that overall scheme. The evidence taken as a whole leads to the conclusion that Prime's transactions with the appellant were connected with that fraudulent scheme by being used to disguise the existence of the defaults of other parties and by providing funds for the fraud.

Nil balances of circular transactions.

141. Mr Puzey demonstrated that where the FCIB evidence had shown circular payments the overall effect of all the transactions within the circle, when looked at as a whole, was that the transactions were neutral and the money had gone round to no economic effect without any apparent purpose. No additional money had been introduced and none had been lost within the circle. That fact was specifically demonstrated during the hearing in respect of two transactions and although, in a third transaction there was a small discrepancy, Mr Puzey later told us that he had reworked the figures and that transaction was neutral in the same way. Mr Puzey contended that the same result applied in respect of all the transactions where the funds had been traced and invited the appellant to contradict his assertion if they thought the calculations were incorrect. Mr Patchett-Joyce agreed that no purpose would be served by going through every transaction in evidence and the appellant has not put forward any argument that the effect of the transactions was other than as alleged by the Commissioners and as proved in the case of the three examples that were put forward.

142. The exercise looked only at the payments that were made and therefore left out of account the fact that the appellant was claiming input tax repayments. Had they been made, the overall effect of the transactions would be that the only sum that did not balance out in the circle of transactions would be that payment made by HMRC to the appellant.

143. The Commissioners argue that the exercise carried out demonstrates that the appellant must have been actively involved in the fraud because the circle of payments depended not only on the appellant buying and selling from and to the right parties but also at the right prices. We do not agree that that is necessarily the case. It is possible that the organisers of the fraud simply manipulated the transactions with the appellant with a view to achieving the neutral effect described or manipulated the other payments in the circle once the deals with the appellant were in place.

144. Clearly, the neutral effect of the circular transactions is yet further evidence that the transactions were part of an overall fraudulent scheme because they could not have occurred in this way by accident. This evidence is also very relevant to proof that the transactions with the alleged contra-traders did have the characteristics alleged by the Commissioners, that is to say they were transactions which served no purpose other than to be offset against the dirty chain fraudulent transactions.

145. The Commissioners were not able to suggest how the various parties involved in these transactions might have been paid for their involvement in the fraud but we do not consider that that detracts from the relevance of these transactions as evidence of contra-trading as a real phenomenon, as opposed to one invented by the Commissioners; as the appellant would have us find. The purpose of these transactions within the fraudulent scheme as a whole is achieved, even if the parties receive no payments from them, if their purpose is to hide other transactions in which fraudulently obtained money is obtained by those parties.

146. The appellant would have obtained a profit if, but only if, the input tax had in fact been repaid or will do so if we find in its favour in this appeal that the input tax is repayable.

Finding upon the ‘connected with fraud’ issue.

147. We find that the disputed input tax claimed by the appellant was connected with the dirty chain fraudulent defaults through the contra-traders as alleged by the Commissioners. The findings that all the contra-traders were dishonest and that the defaulters were dishonest leads to the finding that the transactions did have the effect of disguising the dishonest transactions by offsetting the input tax, that they had the effect of helping the contra-traders to appear to have legitimate businesses and that they provided funds in support of the contra-traders activities which must in part have assisted them in carrying out the dirty chain transactions. The circularity question just addressed very strongly supports the conclusion that the relevant transactions are in fact connected with the fraud in the way described.

The appellant’s evidence.

148. The appellant company called two witnesses, Mr Nils Wager, its sole shareholder at the relevant time and Mr Khalid Khan its director and manager at the relevant time. Both gave evidence about their impressive records in business in various enterprises. Mr Khan graduated from University with a 2:1 degree in banking and financial services.

149. Mr Wager set up the appellant company in 1997, initially with capital provided by Matrix USA, and at that time there were three shareholders but Mr Wager bought the others out and became the sole shareholder in 2002 and from 2003 Mr Khan ran the company as its director and Mr Wager ceased to be actively involved from day to day.

150. The company initially traded in what Mr Khan termed branded goods by which he meant computer equipment manufactured by leading international companies. The company was very successful and it had achieved sales of £44,000,000 in 1999. That trade typically took the form of purchasing stock from the EU which was paid for at the time of purchase and which was brought to the company's warehouse in bulk from where it was sold to customers in the UK from stock in smaller parcels and on 30 days' credit terms. The company had credit insurance to cover the sales to its customers at that time.

151. The company had very secure warehouse premises suitable for holding high value stock.

152. A large loss on a particular transaction and the departure of sales staff brought about difficult trading conditions and the appellant's sales dropped to £16,800,000 in 2001.

153. Mr Khan's evidence was that the appellant started to trade in what he termed non-branded hardware and software in the middle of 2003. By non-branded he meant goods produced by lesser known manufacturers. He stated in his witness statement that non-branded goods were 50% of the company's turnover in 2005 and 65-70% in 2006. In fact, as Mr Khan agreed when he was cross-examined, the sales in the ten months ending May 2006 consisted of £71.16.M of which £68.6M were of what Mr Khan called the non-branded goods making the latter 96% of the total. It is difficult to see how Mr Khan, as the person with day to day control of the business, could have been unaware of the fact that his estimate of 65% to 70% was so significantly incorrect so far as the relevant period is concerned.

154. When he was cross examined Mr Khan agreed that the goods in the transactions under appeal did not come to the appellant's premises except for the goods sold to Canada, that the supplier and customer had been matched (which we take it means that the goods were not split into smaller parcels for resale as is indeed obvious from the paperwork) and that the appellant had not itself inspected them. The Freight Forwarders did carry out inspections for the appellant. He did not like the term back to back but he did agree that the customers were not given credit and that the appellant did not have to pay its supplier until it was paid by its customer.

155. Mr Khan was evasive at times when giving evidence.

156. For example, when it was put to him that he knew that back to back trading in high value computer components was a trade targeted by VAT fraudsters he replied "Not necessarily, no". It was then put to him that he knew VAT fraud was rife in the field of high technology components and he replied "I was aware that VAT fraud

existed". Asked if that was including in his industry he replied "There could have been VAT fraud in this industry too, yes". That last answer contradicted a statement he had made in examination in chief in which he said he had a general knowledge of MTIC fraud. Questions then followed about advice and warnings he had received about the need to take care and he replied "I don't recall that" and said he did not recall visits but soon afterwards he admitted that the appellant had received a letter giving such warnings and that another company in which he had had an interest had received a letter warning it that its transactions had led back to defaulting traders which had been a shock to him. His initial reluctance to admit that he was aware of fraud in the industry was therefore shown to have been evasive.

157. Another example of evasiveness was that Mr Puzey put it to Mr Khan that the difficult trading circumstances referred to above had made the company lose money to which Mr Khan said "It had a big impact on the business, yes". Mr Puzey then put it to him that there were quarters when it was making a loss and Mr Khan said he could not recall the specific profit and loss numbers. We think it most unlikely he could genuinely have forgotten that the company had made losses in some periods.

158. Mr Khan claimed that the appellant was able to trade as successfully as it had done in the relevant period because it had a very good reputation and was well known in the industry. He was unable to offer a convincing explanation as to why suppliers were willing to sell goods to the appellant, which it then sold on to EU customers at a good profit, rather than those suppliers having sold the goods direct to the EU customers. As an experienced businessman we believe that was a question that ought to have occurred to him. The appellant also appears to have had little difficulty in finding buyers and it should have occurred to Mr Khan to at least wonder if the trade was not too good to be true. We do not find that in itself proves the respondents' case but we do find it to be significant that Mr Khan would have us believe that he had not even entertained the possibility that the ease with which the company was able to trade was questionable.

159. The appellant's use of the FCIB bank was raised. Mr Khan explained that the appellant began to use that bank because of the speed with which transactions could be completed and because there was a fear that the UK banks might cancel the company's account, as had happened with another company in which Mr Wager was involved. A Mr Nixon visited the appellant to carry out due diligence on the appellant for the FCIB before it opened the account. Mr Khan had originally said that Mr Nixon had spent a whole day at the appellant's premises but it was shown that he had in fact not arrived until 2.30pm. The terms in which Mr Nixon certified that the appellant was a suitable customer for the bank appear to us to be unjustified. Mr Nixon had only seen documents held by the appellant and to have talked to Mr Khan but he purported to be able to certify that the appellant had "good standing in personal and business community".

160. The appellant asserted in writing to the FCIB bank that it would, amongst other things, determine its suppliers' history in the trade and determine whether normal commercial arrangements were in place for financing the goods, that it would ensure that the goods were insured and that it would determine that there would be adequate

recourse if the goods were not as described. When asked if he had complied with those requirements Mr Khan was only able to say "We certainly tried the best we could". As will be seen hereafter the appellant did not achieve those objects and whilst that might be said to be an issue between it and the bank we also regard it as significant that trading was conducted without those conditions being in place because, whether or not the appellant otherwise saw a need for compliance with such conditions, it had at least been put on notice by its own bank that they were necessary.

161. The appellant failed adequately to insure the goods it shipped abroad. The ownership of the goods was, according to the appellant, not to pass to its customers until it had been paid but although there was transit insurance in place the appellant simply assumed that its freight forwarder would have ensured that insurance would remain in place until the buyer paid for the goods. The appellant assumed its freight forwarder would have arranged that with the buyer's freight forwarder. When pressed, Mr Khan was only able to claim that there were unrecorded discussions with the appellant's freight forwarders which had led to his belief that the goods were adequately covered by the purchasers' freight forwarders. Bearing in mind that the goods in question were worth many millions of pounds we find that to be an extraordinarily lax arrangement at best and given Mr Khan's experience in business we find it most extraordinary that he was prepared to deal in that lax way.

162. The same applies to the contractual terms between the appellant and both its suppliers and customers. Everything ultimately depended on understandings and unrecorded discussions according to Mr Khan. The appellant's suppliers and the appellant itself had terms of business set out in some of the documents passing between them and these terms were at odds with each other.

163. The suppliers were not going to be paid until the appellant had been paid by its customers and so it might be expected that the suppliers would have retention of title clauses in their agreements with the appellant and in at least some cases the suppliers' standard terms did have such clauses, indeed in some cases there were clauses providing that the goods would not even be released to the appellant until payment. It was very clear that what actually happened was that the appellant was allowed to take possession of the goods and ship them to a foreign destination, of which the supplier might not even be aware, on terms that the supplier would be paid only when the appellant was paid by the foreign buyer. No terms were agreed as to how long the period of credit thus given by the supplier to the appellant might be.

164. Similarly, the buyers' terms included terms about when delivery would be made and about responsibility for the quality of the goods which conflicted with the appellant's terms.

165. Mr Khan claimed that the actual situation whereby the appellant was allowed to take possession of goods worth millions of pounds on terms highly favourable to the appellant and potentially ruinously unfavourable to the suppliers had arisen from understandings between the parties. At first Mr Khan claimed these favourable terms were based merely on understandings between the parties but when pressed he claimed that he had agreed them on the telephone with each of the counterparties. He

admitted he had made no note of these telephone conversations and he claimed, also when pressed, that the reason for that was that he was constantly on the telephone and simply would not have had time to make a note of all his calls. However much time he spent on the telephone we do not accept that he would have been unable to make some kind of note, however brief, about such matters as having agreed with a particular supplier that they would release goods but not require payment until the appellant had been paid by its customer. The appellant's deals were all worth very large sums and there were very few of them. The task of recording basic details of the deals once they had been agreed would have been easily achieved. As well as there being only a handful of deals each month the appellant had staff who could have assisted in making such notes.

166. The appellant produced documents which showed that the prices of the goods in question had been negotiated. It appears from those documents that the prices were not simply dictated to the appellant, as might have been the case if the commissioners were correct to assert that the fraudulent scheme could only work if the appellant was fully aware of what was required of it by the organisers of the fraud. Mr Khan said that he tried to negotiate a final small adjustment of the price of goods after a deal in principle had been struck. These marginal adjustments to the price were, he claimed, agreed on the telephone but again no notes were kept.

167. In respect of at least some of the deals the inspections of the goods on behalf of the appellant were carried out several days before it agreed to buy them. The commissioners assert that was because the deals were contrived and all the relevant parties knew they would go ahead regardless of any problems that might have been shown by a genuine inspection. Mr Khan said that was not the case. He also said at different points in his evidence that inspections were carried out before or after the appellant had agreed to buy the goods. There were also cases where the inspection report post dated the departure of the goods and Mr Khan sought to explain that by saying that the result of the inspection must have been given by telephone followed by a written report.

168. The relevance of the issue of laxity in recording the supposed terms of trading and other details is that it calls into question the appellant's assertions that the transactions were, or appeared to it to be, normal commercial transactions. We find that the terms were not normal at all. The appellant was allowed to take goods of high value into its possession without payment and contrary to the suppliers terms of business and then to send them abroad without adequate insurance to a purchaser about which the supplier knew nothing (otherwise the supplier would presumably simply have sold the goods to that purchaser). The goods were then stored in the purchaser's freight forwarder's premises without the appellant being able to say for certain that they were insured. The goods were then paid for at a time of the purchaser's choosing and then the appellant's supplier was paid much later than the terms of business required without any adverse consequences for the appellant. All of these facts are entirely inconsistent with the appellant's frequently asserted description of the business in which it operated as being dynamic and fast moving. The appellant relied upon the fast moving nature of the business to explain such

questions as inadequate due diligence and lack of recording of terms but that is shown to be untrue by the subsequent delays in payment and completion of the transactions.

169. The appellant's enquiries about the purchasers to whom it was sending goods of great value are significant. It must have been obvious that there was a risk inherent in sending goods to a buyer abroad on such uncertain contractual terms and without any more than an assumption that insurance was in place. It would of course have been less risky if the appellant could be certain about the integrity and financial standing of the companies to which the goods were being sent.

170. Mr Khan said in his evidence in chief that he placed great emphasis on having discussions with his suppliers and customers before dealing with them. In particular he stressed that he perceived it to be necessary to confirm that they had a good knowledge of the products they were dealing with, and market awareness and level of experience. He apparently was unconcerned to satisfy himself about their financial standing. At least as far as the overseas customers were concerned it seemed, as he described his enquiries in his evidence in chief, that he had mostly relied only on telephone contact which would not really have enabled him to make any assessment of their financial standing.

171. The appellant's enquiries about CEMSA in Spain, a customer to which the appellant sent goods worth £1,599,600 relevant to this appeal, included a Dun and Bradstreet report which stated that the company's last accounts had been submitted in 2002. Mr Khan said he could not recall if he visited CEMSA and that he "would have discussed with the customer" why it had not submitted its accounts and had satisfied himself by telephone discussions, of which he admitted he had made no record, that it was a reputable company. We find that to be a wholly inadequate basis for dealing with that company and given Mr Khan's experience in business we find it to be significant that he was prepared to risk dealing with it on the basis of those enquiries.

172. The appellant sold goods worth £5,331,150 to 2Trade in Belgium. At first Mr Khan said he had visited the company before dealing with them and then he corrected himself and said he did not know when he had visited them. A Dun and Bradstreet report had said the maximum suggested credit for the company was €3,750. He said that he had not offered credit to them as the goods would not be released until the appellant had been paid and that he had satisfied himself about them in discussions which gave him a good knowledge of their business. It appears that Mr Khan was not concerned about how a company like that could have afforded to pay for goods to the value in question. It also appears clear that there was an inherent risk in sending goods to that value to such a purchaser on what were essentially informal terms. The very least that could be said is that there must have been a risk the company would not be able to pay for the goods and that they would have had to be returned to the UK at the appellant's cost leaving it with a huge debt to its supplier and goods which might have changed in value in the rapidly changing market described by Mr Khan.

173. The appellant sold goods worth £1,231,500 to Future Tech in Canada. Obviously the costs of sending the goods to Canada were significant and any risk that they might have to be retrieved if the buyer failed to pay was higher than with the

European buyers. The Dun and Bradstreet report, which was the only documentary due diligence produced in respect of Future Tech, said that the president of the company had refused to give a current financial statement. Mr Khan said that did not cause him concern.

174. The appellant sold goods worth £2,040,700 to Mona in Luxembourg. The appellant was unable to produce any documents to show that it had made any enquiries about that company's financial standing. Mr Khan did not suggest that any such documents had ever existed.

175. The appellant sold goods worth £6,896,750 to Universal Transolution Group SL in Spain (T/A Logout). Dun and Bradstreet recommended a credit guide of €2,000 and the turnover of that company for 2004 was stated to be €264,000. The first check with the Commissioners' Redhill office to confirm the VAT registration of Universal Transolutions produced by the appellant was after the first five of the thirteen deals with that company had taken place though Mr Khan said there would have been a National Enquiries office check that he "imagined would have been" noted at the time. No file note to that effect was produced. Mr Wager gave evidence that he had visited Universal Transolutions in, he thought, January 2006. He kept no notes about the visit but he said he had discussed the visit with Mr Khan.

176. Mr Khan was also cross examined about what the appellant knew about its suppliers. It was less essential for the appellant to be sure about its suppliers' financial standing than was the case with its customers because the suppliers were, albeit contrary to their terms of business in at least some cases, prepared to give the appellant credit and to release the goods and even to transfer ownership before payment. Despite that, normal commercial risks would potentially arise such as a dispute as to the quality of the goods supplied so it was of some relevance for the appellant to know what its suppliers' financial standing was.

177. In addition, the appellant did in fact make some enquiries about the suppliers and, its having done so, it is relevant to consider whether what the appellant knew about its suppliers was such as to raise questions in Mr Khan's mind about how they were able to supply goods to the value they did and then to wait for payment for an indeterminate period until the appellant was paid by its customers.

178. CCM supplied goods worth £2,719,237.50 to the appellant. The Dun and Bradstreet report showed that that company had had three County Court judgments made against it in 2005. Mr Khan said he had discussed this with a representative of CCM (which was a neighbouring business of the appellant) and it had been explained that an invoice finance facility from CCM's bank had been withdrawn and that had caused small liquidity problems.

179. Churchill International Trading Ltd supplied the appellant with goods worth £1,973,100. The appellant produced accounts for Churchill but these had been provided after the deals in question had already been carried out. Mr Khan said he had had discussions with Churchill with whom he had a good relationship and that they had explained that they were in discussion with their accountants which had

delayed the accounts. He admitted that a Dun and Bradstreet report had not assisted his decision to deal with Churchill.

180. Signal Telecom Ltd supplied goods worth £2,672,032.50 to the appellant. Mr Khan admitted that the risk indicator on a report held by him was significant but asserted that as the appellant did not give Signal credit he had not been worried about that. He admitted that he did not know they were not going to default after promising goods but claimed to have been satisfied they would not; from discussions he had had with them.

181. Starmill International Limited supplied goods worth £6,005,250 to the appellant. The appellant knew that that company had made a loss of over £100,000 in two successive years. Mr Khan claimed to have been satisfied about dealing with that company as a result of conversations with other people in the industry.

182. DB Computers Ltd supplied goods worth £5,424,000 to the appellant. Mr Khan admitted that that company had an extremely modest financial position and fixed assets of £3,720 and asserted that he had relied upon discussions with the company's management for his decision to trade with it.

Our findings.

183. We have already found that the transactions in question were, as a matter of fact, connected with the alleged dirty chain defaults through the contra-traders as alleged by the Commissioners. The connections are proved whether or not the appellant was aware of them. We have also found that all the alleged contra-traders were dishonest and that all had dishonestly engaged in transactions leading back to dishonest defaulters who had caused or been involved in causing losses to the revenue.

184. The remaining question is therefore whether the Commissioners have proved on a balance of probabilities that the appellant knew or should have known that its transactions were connected with the fraudulent transactions.

185. We do not find that the evidence proves that the appellant knew all the details of the connections between its transactions and the fraudulent transactions. We do not agree with the Commissioners' assertion that for the fraudulent scheme to have operated the appellant must have been fully aware of the details of the scheme or to have been, in effect, told what to do so far as concerned who to buy from, who to sell to and what prices to pay and charge.

186. We have taken into account all the evidence given by both parties. The legal burden of proof is on the Commissioners. They had presented credible evidence sufficient to make a finding against the appellant and the appellant did not submit there was no case to answer and gave evidence, mainly through Mr Khan and to a very limited extent also through Mr Wager. Accordingly it is clear we must decide the appeal on all the evidence.

187. Having examined all the evidence we have concluded that the appellant did know that its transactions were connected with fraud. We will summarise some of the

more obvious points we have taken into consideration but we do stress that it is the cumulative effect of all the evidence that has led to our conclusion.

188. Mr Khan's evidence was unsatisfactory and incredible in a number of respects. He was evasive at times. He also asked us to believe that he had been too busy to make even the most cursory notes of vital telephone conversations that he claimed he had conducted with counterparties in which terms of business relating to goods worth millions of pounds had been agreed. Those terms were often variations of the respective parties' written terms of business. We find it incredible that he, as an experienced and educated businessman, would have acted in that way. We find it to be untrue that he was too busy to make those notes and asking ourselves why he should lie about that in evidence we can only conclude that he did so because he knew that the truth was that the transactions were contrived and that they would proceed however informal the arrangements between the parties were.

189. Even if the appellant was not party to all the details of the fraud that contrivance is enough to show that the appellant knew that the transactions were connected with fraud. In this context it is, of course, highly relevant that Mr Khan knew that fraud was a serious problem in the trade in which the company was involved and his reluctance to admit it when he gave evidence underlines that he was fully aware of the relevance of that fact.

190. The apparent lack of concern about the terms of business exhibited by the appellant's suppliers must have been obviously suspicious. They allowed the appellant to have possession or even ownership of goods worth millions of pounds which they allowed it to send abroad without payment even of a deposit or without proof of insurance and upon terms so favourable to the appellant that Mr Khan must, at the very least, have been suspicious about the transactions.

191. The terms as to payment were that the appellant would only have to pay its suppliers when its customers paid it. There was no set limit as to how long the suppliers would give credit and no provision for interest in the event of delay. The unsatisfactory nature of the transactions from the suppliers' point of view must have been obvious to Mr Khan. If it is also taken into account that they were apparently not substantial businesses as far as their own financial standing was concerned and that Mr Khan knew that; then it must have been obvious that the transactions could not have been genuine. We regard the cumulative effect of the evidence as sufficient to prove that Mr Khan knew, not just that he suspected or should have known, that the suppliers could not be acting other than dishonestly.

192. Similarly, we find that the willingness of the appellant to deal with its customers on terms very favourable to them is equally proof that Mr Khan knew that the transactions were contrived and connected with fraud. In some cases at least, the customers were apparently unable to afford the goods they were buying according to reports the appellant had obtained. Despite that the goods were shipped to the customers' Freight Forwarders without adequate confirmation of insurance and on vague terms as to when payment would be made. The way the appellant dealt with the customers involved very obvious risks.

193. We find the appellant's explanation of why it was prepare to deal with its counterparties in the circumstances that we have described is wholly incredible. Mr Khan's explanation that he satisfied himself that he could safely commit the appellant to transactions on the basis that the counterparties were familiar with the trade and had a good knowledge of the goods being traded and the market in them seems to us to be completely illogical. It must have been obvious that the financial standing of the other parties was far more important than their knowledge of the goods and the market in them.

Conclusions.

194. The appeal is dismissed. The appellant is not entitled to credit for or payment of the input tax in question because it knew that the transactions in question were connected with VAT fraud.

195. Any application for costs is directed to be made to the Tribunal within 42 days of the release of this Decision. If any such application is made it can be but need not, at that time, be quantified and an application in principle only will be considered if made.

196. 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.

RICHARD BARLOW

TRIBUNAL JUDGE
RELEASE DATE: 29 November 2011