TC02852

Appeal number: TC/2010/00065

VALUE ADDED TAX – input tax – denial of right to deduct on grounds that the Appellant knew or should have known that the transaction was part of fraud by others – alleged MTIC – whether shown that the Appellant's transactions connected with fraudulent evasion of VAT – yes – whether Appellant "knew or should have known" of fraud – yes – valid refusal of right to deduct – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

DD JEWELLERS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE J BLEWITT
MR T. MARSH

Sitting in public at London on 22, 25, 26, 27, 28 February 2013 and 5 March 2013

Mr R. Holland of Dass Solicitors for the Appellant

Mr J Kinnear QC leading Mr H. Watkinson, Counsel instructed by the Respondents

DECISION

Introduction

1. This is an appeal against HMRC's decision, contained in a letter to DD Jewellers Limited ("DDJ") dated 9 September 2009, denying it entitlement to the right to deduct input tax in the total sum of £501,261.25 claimed in the VAT quarterly accounting period 09/06. The disputed input tax was incurred in the purchases of mobile telephones, HMRC say, as set out in its Statement of Case that the input tax incurred by the Appellant was done so in a transaction or transactions connected with the fraudulent evasion of VAT and that the Appellant knew or should have known of this fact. The Appellant maintains that it did not know and had no means of knowing that its transactions were connected with such fraud.

2. Mr Kinnear QC of Counsel, leading Mr Watkinson appeared on behalf of HMRC. Mr Holland appeared on behalf of the Appellant. Both produced written submissions which set out the issues to be determined by us. We were also provided with a large number of lever arch files containing witness statements and documentary exhibits relied upon by both parties.

3. We heard evidence from the following witnesses:

- Mrs Heather Arnold, Case Officer of HMRC responsible for issuing HMRC's decision following the extended verification of VAT period 09/06;
- Mr Lucas Agathocleous, Director of Appellant Company;
- Mr John Alexandrou, Director of Appellant Company.

Other witnesses who were not called to give evidence but whose statements stood as their evidence were:

- Mr Rod Stone, HMRC Officer who provides an overview of the general nature and features of MTIC fraud;
- Ms Lesley Camm, HMRC officer assigned to alleged contra-trader Optronix Ltd ("Optronix");
- Ms Carol Batley, HMRC officer assigned to alleged contra-trader Optronix Ltd ("Optronix");
- Mr Olutoyin Alabi, HMRC officer assigned to alleged defaulter Keycomp Ltd ("Keycomp");
- Mr Adam Smith, HMRC officer assigned to alleged defaulter The C Corporation Limited ("C Corp");

- Ms Julie Yeomans, HMRC officer assigned to alleged defaulter Synergi-Tec Limited ("Synergi-Tec");

- Mr Clive White, HMRC officer assigned to A1 Inspections Ltd ("A1");

- Mr Mark Jarrold, Officer involved in Operation Vex;

- Mr Nigel Humphries, HMRC officer who provided an overview of the contra-trading scheme;

- Mr Gary Taylor; Director of PWC who provided an overview of the grey market.

Missing Trader Intra-Community Fraud

4. It may assist in understanding the facts of this case to give a brief overview at this point of the description coined by HMRC and which applies to this case; contra-trading. Essentially contra trading is a variation on MTIC trading. In ***HMRC and Livewire & HMRC and Olympia Technology Ltd*** [2009] EWHC 15 (Ch) *at paragraph 1* Lewison J provided this clarification as to the different forms that MTIC fraud can take:

"i) In its simplest form it is known as an acquisition fraud. A trader imports goods from another Member State. No VAT is payable on the import. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The importer is labelled a "missing trader" or "defaulter".

ii) The next level of sophistication involves both an import and an export. A trader once again imports goods from another Member State. No VAT is payable on the import. Typically the goods are high value low volume goods, such as computer chips or mobile phones. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The domestic buyer sells on to an exporter at a price which includes VAT. The exporter exports the goods to another Member State. The export is zero-rated. So the exporter is, in theory, entitled to deduct the VAT that he paid from what would otherwise be his liability to account to HMRC for VAT on his turnover. If he has no output tax to offset against his entitlement to deduct, he is, in theory, entitled to a payment from HMRC. Thus HMRC directly parts with money. Sometimes the exported goods are re-imported and the process begins again. In this variant the fraud is known as a carousel fraud. There may be many intermediaries between the original importer and the ultimate exporter. These intermediaries are known as "buffers". The ultimate exporter is labelled a "broker". A chain of transactions in which one or more of the transactions is dishonest has conveniently been labelled a "dirty chain". Where HMRC investigate and find a dirty chain they refuse to repay the amount reclaimed by the ultimate exporter.

iii) In order to disguise the existence of a dirty chain, fraudsters have become more sophisticated. They have conducted what HMRC call "contra-trading". The trader who would have been the exporter or broker at the end of a dirty chain, with a claim to repayment of input tax, himself imports goods (which may be different kinds of goods) from another Member State. Because this is an import he acquires the goods without having to pay VAT. This is the contra-trade. He sells on the newly acquired goods, charging VAT but this output tax is offset against his input tax, resulting in no payment (or only a small payment) to HMRC. The buyer of the newly acquired goods exports them and reclaims his own input tax from HMRC. Again there may be intermediaries or buffers between the contra-trader and the ultimate exporter. The fraudsters' hope is that if HMRC investigate the chain of transactions culminating in the export, they will find that all VAT has been properly accounted for. This chain of transactions has conveniently been called the "clean chain". Thus the theory is that an investigation of the clean chain will not find out about the dirty chain, with the result that HMRC will pay the reclaim of VAT on the export of the goods which have progressed through the clean chain."

5. In the present case, one which involves "contra-trading" the Appellant was, in all transactions, in the position of "broker"; ultimate exporter of goods in a "clean chain". We should note that throughout this decision the use of the terms "contra-trading", "clean chain" and "dirty chain" are used for the purposes of convenience and without any inference of pre-judging the issue.

6. It is not alleged by HMRC that the transactions in the Appellant's chain led to any tax loss, but it is alleged that the use of dirty and clean chains were a device used for the sole purpose of cheating the Revenue. In the first chain of transactions the contra-trader acquired goods from a trader in another member stated which were zero rated for VAT. The goods were purportedly sold to another UK based trader (commonly referred to as a buffer) and received output tax. Instead of paying the output tax to HMRC the contra-trader offset it against a claim for input tax incurred in a second set of transactions. The goods were sold through a number of UK buffers until purchased by the Appellant which then exported the goods via a sale to a trader in another member state in a sale that was zero rated. It is the Appellant's resulting claim for repayment of its input tax which is the subject of this appeal.

7. In the same tax period the contra-trader acted as a broker in the "tax loss chains". In this set of transactions the contra-trader purchased goods from a UK company and sold them to a trader in another member state thereby creating an entitlement to deduct input tax. All of the transactions were traced back to defaulting traders whose purported onward sale created a liability to account for output tax which was never paid or accounted for thereby creating a tax loss.

8. It is the case for HMRC that the contra-trade transactions formed part of an overall MTIC fraud scheme involving a network of companies and chains of contrived transactions the sole aim of which was to defraud the Revenue.

Legislation and Case Law

9. Article 17 of the Sixth Council Directive of 17 May 1977 provides for the scope of the right to deduct. The provisions of sections 24 – 26 of the Value Added Tax Act 1994 and the VAT Regulations 1995 are in mandatory terms; if a trader has incurred input tax, which is properly allowable, he is entitled, as of right, to set it against his output tax liability or to receive a repayment if the input tax credit due to him exceeds that liability. A trader is required to hold evidence to support his claim (under article 18 of the Sixth Directive and Regulation 29 (2) of the Value Added Tax Regulations 1995 (SI 1995/2518)). The right to deduct or right to a repayment is absolute and there is no discretion on the tax authority, save that the authority may accept less evidence than normally required.

Submissions on behalf of the Appellant

10. Mr Holland on behalf of the Appellant made a number of submissions as to how the Tribunal should interpret the relevant legislation and recent case law. His starting point was paragraph 59 of *Kittel v Belgium, Belgium v Recolta Recycling* [2008] STC 1537*("Kittel"):*

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

11. Mr Holland noted that HMRC had relied on, as its starting point, UK case law in which *Kittel* has been interpreted and applied, with particular reliance placed on *Mobilx Ltd and The Commissioners for Her Majesty's Revenue and Customs, The Commissioners for Her Majesty's Revenue and Customs and Blue Sphere Global Ltd, Calltel Telecom Ltd & another and The Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517 ("*Mobilx*").

12. The Tribunal was invited to recognise the primacy of EU law and, in such circumstances apply a starting point of Articles 167 and 168 of Directive 2006/112 ("the VAT Directive"), CJEU case law and VATA 1994. Mr Holland submitted that if a Directive which creates rights has been inaccurately transposed into domestic law, a taxable person is able to rely on his Directive rights or domestic statutory right, whichever is the more favourable. Even in circumstances where a superior court has failed to apply EU law, it remains the obligation of the inferior court to do so.

13. In the recent joined cases of *Mahageban* and *David* (C-80/11 and C-142/11 respectively) ("*Mahageban*") the CJEU analysed the relevant law. Mr Holland submitted that the facts of *Mahageban* are applicable to the present appeal as the conditions set out by the CJEU are fulfilled; namely that a transaction was carried out and that the corresponding invoice was in order. Consequently the criteria for the creation and exercise of the right of deduction have been satisfied.

14. Mr Holland recognised that the benefit of the right of deduction can be lost and submitted that there are conditions for such a loss to arise:

- On the basis of case law resulting from *Kittel;*
- Objective factors proven by HMRC;
- Compliance with the fundamental principles of EU law.

15. In summary, Mr Holland contended that there is nothing in *Kittel* or subsequent case law which supports the proposition that *Kittel* can be extended to the present facts. Further, the principle of legal certainty requires that an exception to a fundamental principle of the common system of VAT must be clear, precise and predictable. Finally, the relevant principles of EU law to be adhered to are legal certainty, proportionality and fiscal neutrality.

16. We were provided with detailed written submissions from Mr Holland. We do not intend to repeat the contents of the document to any significant degree but will provide an overview of the salient points.

17. It is clear from *Kittel* when read in light of the *Mahageban* judgement that the right of deduction cannot be refused, only the benefit of that right, even in circumstances where the claimant is a fraudster. On the basis of that distinction, a fraudster cannot be deemed to be outside (or "outwith") the scope of VAT. The words "by his purchase" in the following paragraph (emphasis added) (59):

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

Were replaced in *Mahageban* (45) by *"to whom were supplied the goods or services which served as the basis on which to substantiate the right to deduct"* from which it is clear that the objective factors must point to an infringement or fraud at an earlier stage of the supply sequence leading to the goods being offered to the taxable person (and that the taxable person knew or should have known of the factors prior to entering into the deal).

18. The inclusion of the words in *Kittel* (emphasis added) "*having regard to objective factors…and to do so even where the transaction in question meets the objective criteria…"* provides a clear distinction between the objective criteria and objective factors which is also found in Mahageban in which references to *"substantive and formal conditions"* and "*objective factors"* is made. Mr. Holland contended that *"criteria"* are relevant to the determination of whether the principles of the VAT system have been fulfilled, of which there can be no doubt in this case.

"Conditions" refer to those that must be fulfilled for the right of deduction to arise and be exercised, again a fact of which Mr. Holland contended there could be no doubt. *"Factors"* relate to the transaction in issue; HMRC must establish one or more objective factors in each transaction from which a conclusion of knowledge can be reached. Furthermore, (relying on *Mahageban* at 61 - 65, *LVK* 61, 62 and 62 and *Story Trans* at 49, 50 and 52) HMRC cannot require the claimant to make checks that were not his responsibility and as such the detection of fraud rests with HMRC.

19. Mr. Holland submitted that the limited scope of the interpretation set out above impacts on the judgment of *Mobilx* in that the Court of Appeal erred in failing to have regard to the distinction between *"objective factors"* and *"objective criteria"*. In failing to so do, Moses LJ was incorrect in holding that the transactions were not within (i.e. "outwith") the common system of VAT.

20. The objective factors must pertain to the transaction into which the taxable person has entered and failure by that person to carry out checks on his supplier is not an objective factor. Furthermore the taxable person must be in possession of material which justifies the suspicion that fraud has been committed at the time or before the transaction was entered into.

21. The Court of Appeal's reference to the *"only reasonable explanation"* is a test in relation to whether a person should have known that his transactions were linked to fraud and has two serious defects:

- Such knowledge can only be judged ex post facto and by reference to extrinsic facts about which the claimant could not have known which infringes the principle of legal certainty; and

- There is concern as to whether the *"only reasonable explanation"* relates to the transaction or the circumstances in which the transaction took place. If the former, the test is unlikely to be satisfied as the most reasonable explanation for a commercial transaction is just that: a commercial transaction. If the latter, relevant circumstances are to be distinguished from *"objective factors"* and any wider test (which Mr Holland submitted relevant and surrounding circumstances would be) must be wrong in law.

22. In summary, for the benefit of the right to deduct to be lost, HMRC must point to objective factors of the impugned transactions of which the Appellant knew or should have known at the time of entering into the transactions. The Tribunal must not regard as objective factors, checks and investigations which the Appellant had no responsibility to carry out. If HMRC considered anything in the Appellant's trading to be irregular or fraudulent, it was HMRC's responsibility to take action as the Appellant had not been warned of tax losses in any deals prior to the period with which we are concerned. Furthermore the evidence relied upon by HMRC in proving this case do not constitute objective factors and the issue of due diligence carried out by the Appellant is not a matter upon which HMRC can properly rely as a matter of community case law, as to do so would be to transfer HMRC's own investigative obligations onto the Appellant.

HMRC's Submissions

23. HMRC agreed that there is a distinction to be drawn between the "*objective criteria*" by which the scope of VAT (and therefore the right to deduct) is to be determined and the "*objective factors*" by which it is to be determined whether a taxable person knew or should have known that his transaction was connected to the fraudulent evasion of VAT. The objective criteria are those which form the basis of the concepts used in Articles 411 and 413 of Directive 2006/112 and ss 1, 4 and 24 VATA 1994.

24. It was made clear in *Mobilx* that the CJEU in *Kittel* extended the principle that the "*objective criteria*" which define the scope of VAT and the right to deduct are not met where a taxable person knew or should have known that his transaction was connected with fraud.

25. The "*objective factors*" to which the CJEU referred at paragraph 59 of *Kittel* are not "*factors*" that directly determine whether the transaction falls within the scope of VAT and the right to deduct; they are factors that determine whether the taxable person knew or should have known that his transactions were connected with fraud, in which case the transaction will not meet the "*objective criteria*" for a transaction within the scope of VAT and the right to deduct.

- Response to Appellant's submission that *Mobilx* has conflated the objective criteria in relation to the existence of the right to deduct with the objective factors to establish knowledge.

26. HMRC do not agree that there was any such conflation. The paragraphs of Mobilx relied on by the Appellant (20, 28 and 30) make clear that all the Court of Appeal have stated is that the objective criteria which determine the scope of VAT are the same as those that determine the scope of the right to deduct:

"*The reasoning which led the Court to the answers it gave to both the first and second questions explains the source, nature and extent of the test it provided for refusal of the right to deduct. The Court's statement of principle depended upon the application of objective criteria which define the scope of VAT. Since the right to deduct is integral to the system of VAT, those objective criteria also define the scope of the right to deduct. It applied those objective criteria to traders who were not themselves fraudulent but knew or should have known their transactions were connected to fraud. By focussing on those objective criteria the court avoided infringing the fundamental principles of fiscal neutrality and legal certainty which lie at the heart of the VAT system.*

Since the right to deduct is fundamental to the system of VAT because it ensures that the charge is limited to the value added at each stage of the supply and because it ensures fiscal neutrality, it may not, in principle, be limited; any derogation from the principle of the right to deduct tax must be interpreted strictly (see Case C-414/07 Magoora [2008] ECR I-000). Moreover, the right must be exercisable immediately in respect of all taxes charged on input transactions. Since the right arises immediately

the taxable person pays tax (input tax) to his supplier, the principle of legal certainty demands that he knows when he enters into the transaction that it is within the scope of the tax and that his liability will be limited to the amount by which any output tax he may be liable to pay, on making a supply, exceeds the input tax he has paid. The objective criteria determine both the scope of the tax and the circumstances in which the right to deduct arises.

The Court rejected the United Kingdom's argument that unlawful transactions fell outside the scope of the VAT. Fiscal neutrality prohibits a distinction between lawful and unlawful transactions; such a distinction must be restricted to transactions concerning products which by their very nature may not be marketed, such as narcotic drugs and counterfeit currency (see § 49 and the Advocate General's Opinion § 40). By its rejection of the United Kingdom argument, the Court made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met."

- Response to Appellant's submissions that the Court of Appeal erred in concluding that transactions can be outwith the scope of VAT and the scope of the right to deduct

27. HMRC submitted that the conclusion reached by the Court of Appeal in *Mobilx* was the only logical conclusion to reach given that the right to deduct cannot be exercised outwith the scope of VAT and the criteria that govern the scope of VAT must therefore also govern the scope of the right to deduct, which is integral to the operation of VAT.

- Response to Appellant's contention that *Mahageban* confines the right to deduct to the case law resulting from *Kittel*

28. It was submitted by Mr Kinnear QC that the CJEU did not make such a broad statement of principle. He highlighted that the CJEU judgment at paragraph 45 begins *"in those circumstances"*, referring to the preceding paragraph which deals with the order for reference and questions referred to the Court. As such the dictum is limited to the factual circumstances of Mahageban's case.

- Response to Appellant's contention that the effect of *Mahageban* is that the principle in *Kittel* cannot apply to contra-trading

29. The judgment of the CJEU is of no assistance to the Appellant as, by reference to the facts before it, the Court did not address contra-trading. The law remains that in Kittel as set out in *Mobilx*. HMRC highlighted the fact that one of the cases before the Court of Appeal in *Mobilx* was *Blue Sphere Global* which involved contra-trading and the issue of connection. The Court of Appeal held that the correct question in a contra-trading case remained whether the trader knew or should have known that by its purchases it was participating in transactions connected to the fraudulent evasion

of VAT. It was submitted by Mr Kinnear QC that in the case of contra-trading, the connection between the Appellant's transactions and the fraud can be proven via the dual connection of (i) the method of accounting for VAT between the Appellant's transaction and the defaulting traders in the contra-trader's tax loss chains and (ii) between the Appellant's transactions and the dishonest cover-up by the contra-trader of its involvement in the tax loss chain.

- Response to Appellant's contention that *Mahageban* and *Toth* are authority for the proposition that the connection must be with a fraud "previously committed…at an earlier stage in the transaction"

30. It was submitted by HMRC that the Appellant's reliance on *Mahageban* in its assertion that there is a temporal constraint in respect of the connection to fraud is wrong in law. In so asserting, HMRC relied on *Stroy Trans EOOD* (C-642/11) and *LVK – 56 EOOD* (C-643/11) in which the CJEU confirmed that connection can be with a transaction prior or subsequent to that of the taxable person and the Court of Appeal's decision in *Mobilx*.

31. Furthermore, Mr Kinnear QC submitted, the judgment in *Mobilx* is binding on this Tribunal and in order to succeed in its argument, the Appellant would have to demonstrate that the CJEU had altered the test in *Kittel* in the course of the *Mahageban* judgment.

- Response to Appellant's assertion that *Mobilx* is wrong in law

32. HMRC cited the case of *S & I Electronics plc. v The Commissioners for HM Revenue and Customs* [2012] UKUT 87 (TCC) ate 13 – 19 in support of its submission that *Mahageban* did not cast any new light on the Court of Appeal's interpretation of *Kittel* so as to make its reasoning unsustainable:

"The submissions advanced by Mr Michael Patchett-Joyce on behalf of S&I were in a range of respects inconsistent with the Court of Appeal's decision in Mobilx. Mr Patchett-Joyce did not shrink from saying that the approach adopted by the Court of Appeal in Mobilx (in which he appeared for all but one of the appellants) was wrong and that we should not follow it. Mr Patchett-Joyce recognised that the Upper Tribunal would normally be bound by decisions of the Court of Appeal, but argued that domestic rules of precedent are inapplicable in the present context. European Union law, Mr Patchett-Joyce pointed out, has primacy over domestic law. Accordingly, so it was submitted, the Upper Tribunal (and also the FTT) must disregard a Court of Appeal decision which fails to reflect European Union law accurately.

Mr Patchett-Joyce advanced similar submissions in another Upper Tribunal case, POWA (Jersey) Ltd v Revenue and Customs Commissioners [2012] UKUT 50 (TCC), Roth J's decision in which was released on 8 February 2012. Roth J, however, regarded Mobilx as binding on him….

"15. The normal rule is that a High Court judge should follow a previous decision of another High Court judge unless convinced that it is wrong: see e.g. R (on the application of B) v London Borough of Islington [2010] EWHC 2539 (Admin), at paragraph 31. Judges of the Upper Tribunal (which was described by Laws LJ as "an alter ego of the High Court" in R (Cart) v The Upper Tribunal [2009] EWHC 3052 (Admin), at paragraph 94) should similarly, it seems to us, usually follow other Upper Tribunal decisions unless convinced that they are wrong. Far, however, from being convinced that Roth J was wrong to take the view that Mobilx is binding on the Upper Tribunal, we agree with him.

Mr Patchett-Joyce observed that Chadwick LJ did not have available to him the subsequent decisions of the ECJ in cases such as Skatteverket v Gourmet Classic Ltd (Case C-458/06), Kücükdeveci v Swedex Gmbh & Co KG (Case C- 555/07), and Elchinov v Natsionalna zdravnoosiguritelna kasa (Case C- 173/09). We do not think, however, that these cases undermine what Chadwick LJ said in the Condé Nast case…

18. If the Court of Appeal "should not refuse to follow [an] earlier decision merely because, on the same material and the same arguments, it is satisfied that a different conclusion should have been reached", still less should the Upper Tribunal take it upon itself to decline to follow a Court of Appeal decision in such circumstances. The position might be different if a subsequent decision of the ECJ had cast new light on the matter, but there can be no question of the Upper Tribunal "substitut[ing] its own view as to the effect of a judgment of the [ECJ] for the view which has been reached by [the Court of Appeal] in an earlier case on consideration of the same judgment in circumstances in which there has been no opportunity for the [ECJ] to review that judgment" (to adapt words of Chadwick LJ).

19. In the present case, the ECJ has not reviewed the relevant law in any significant way since Mobilx was decided in May 2010. It is therefore incumbent on us to follow the interpretation of the law which the Court of Appeal adopted in Mobilx."

33. Mr Kinnear QC also brought to our attention (unreported at the time of the hearing) a refusal by Moses LJ for application for permission to appeal to the Court of Appeal on the principal grounds that CJEU cases either demonstrated that *Mobilx* was wrong in law or supported the argument that the scope of *Kittel* had been limited.

34. HMRC submitted that the judgment of *Mahageban* must be read in the factual context of the questions referred to the CJEU and its specific facts which involved a contract for supply and invoices which were not genuine. Similarly HMRC argued that the cases of *David* and *Toth* are both fact specific. None of the cases, argued HMRC, concerned MTIC fraud or contra-trading and each concerned either a direct supplier or supplier earlier in the chain engaging in fraudulent activity. The principle set out in *Kittel* was, therefore, applied to particular factual circumstances. The questions referred to the CJEU did not concern the scope of the principle of *Kittel* and had the Court sought to amend the principles, it would be expected to have done so in a plain and uncertain manner.

- Response to Appellant's contention that *Mahageban* has affected the issue of due diligence

35. HMRC disagreed that there is a threshold to be met before the taxable person is required to make any enquiries into its supplier. The CJEU was not attempting to define the relevance of due diligence but simply stating that it cannot be a pre-requisite to the exercising of a right to deduct nor is a strict liability approach acceptable.

36. The question addressed by the CJEU in Mahageban was whether the right to deduct could be denied on the basis that due diligence had not been carried out; this is an entirely different issue to the relevance of due diligence in assessing whether the taxable person knew or should have known that its transactions were connected to fraud.

37. In the present appeal HMRC have not sought to transfer its investigative obligations and it is the state of the Appellant's knowledge that is one of the issues for the Tribunal to determine.

Discussion and Decision as to the correct approach to adopt

38. We carefully considered the submissions by both parties and we will deal with each issue raised in turn.

39. We agreed that there is a distinction to be drawn between the terms *"objective criteria"* and *"objective factors."* We took the view that the term *"objective criteria"* relates to the existence of the right to deduct (and therefore it must follow the actual right to deduct) as a principle which defines the VAT system. In our view the wording in *Kittel* at paragraph 59 makes it clear that it is the *"entitlement to the right to deduct"* which can be refused. Any such refusal is based on the Tribunal's conclusion on the issue of knowledge which is determined having regard to *"objective factors"*, which have no effect on the scope of VAT or right to deduct as principles. By way of example, if we begin on the premise that the words *"objective factors"* could include surrounding circumstances and (for the purposes of this example) if we applied those words instead, a taxable person makes a taxable supply which, on the face of it satisfies the objective criteria and thereby that taxable person has the right to deduct. The Tribunal would be entitled, subject to a finding that the surrounding circumstances demonstrated knowledge or that the taxable person should have known of a connection to fraud, to refuse that entitlement as the taxable person, following a finding of knowledge on his part, no longer satisfies the objective criteria. In our view the reference in Kittel: *"and to do so even where the transaction in question meets the objective criteria…"* must be read as the objective criteria in relation to the transaction and not the taxable person. In essence, it is the Tribunal's assessment of the objective factors which determines whether or not the objective criteria are ultimately met.

40. It was clear to us, in applying the analysis of Moses LJ in Mobilx at paragraph 41 with which we agreed, that once the test of knowledge was satisfied, the taxable person's transactions fell outside, or outwith, the objective criteria:

"In Kittel after § 55 the Court developed its established principles in relation to fraudulent evasion. It extended the principle, that the objective criteria are not met where tax is evaded, beyond evasion by the taxable person himself to the position of those who knew or should have known that by their purchase they were taking part in a transaction connected with fraudulent evasion of VAT:-

> *"56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.*
> *57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.*
> *58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them."*
> *59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'…."*

The words I have emphasised "in the same way" and "therefore" link those paragraphs to the earlier paragraphs between 53-55. They demonstrate the basis for the development of the Court's approach. It extended the category of participants who fall outwith the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. Kittel did represent a development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct."

For those reasons we were wholly satisfied that there was no conflation between the objective factors and objective criteria in the judgment of *Mobilx* and that the right to deduct cannot be exercised outwith the criteria which governs the scope of VAT and the right to deduct contained therein.

41. Even if we are not correct on that issue, on the issue of primacy of EU law we had no doubt that the case of *Mobilx* is binding on us for the reasons set out in *S & I*

Electronics plc. v The Commissioners for HM Revenue and Customs and those outlined by Roth J in POWA (Jersey) Ltd v Revenue and Customs Commissioners:

"…the judgment of the Court of Appeal is clear authority, binding on the Upper Tribunal…"

42. We were also satisfied that the CJEU has not altered the law or test to be applied in any significant way since *Mobilx. Mahageban,* as with *Toth* and *David* are cases that were fact specific and the subject of particular questions referred and must be read as such. We concluded that the inclusion in the judgment of *Mahageban* of words such as *"In those circumstances"* were deliberate and designed to indicate that the reader must put the judgment in its correct context.

43. We rejected Mr Holland's submission that the test in *Kittel* does not extend to contra-trading as misconceived. *Mahageban* did not address the issue of contra-trading and we noted that the judgment of the Chancellor in *Blue Sphere Global Ltd v The Commissioners for HM Revenue and Customs* [2009] EWCH 1150 (Ch) was not affected by *Mobilx*. We agreed with the judgment of Roth J in *POWA (Jersey) Ltd v Revenue and Customs Commissioners*:

"…that the fact that the trader claiming credit for input tax did not deal directly with a fraudulent trader but was more remote in the chain does not preclude his being denied repayment under the rationale of Kittel".

44. We also had regard to the case of *Megtian Ltd v HMRC* [2010] STC 840 at 851*("Megtian")* in which it was said:

"I do not read Lewison J's analysis [in Livewire] of the issue as to what must be shown that the broker knew or ought to have known in a contra-trading case as amounting to a rigid prescription that, as a matter of law, such an analysis must be performed in every contra-trading case, such that it will be defective unless it identifies one or other of the alternative frauds as being that which the broker knew or ought to have known.

…Lewison J acknowledged that in many if not most cases of contra-trading, the clean chain and the dirty chain were likely to be part of a single overall scheme to defraud the Revenue. As he put it, at [109]: 'Indeed it seems to me that the whole concept of contra-trading (which is HMRC's own coinage) necessarily assumes that to be so.'

In my judgment, there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.

Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker

ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on the facts of particular cases, including Livewire, that may be an appropriate basis for analysis."

45. In applying the principles set down in the authorities cited at paragraph 45 and 46 above, we concluded that contra-trading is a variant of MTIC fraud and therefore the test to be applied is no different to that in a "typical" MTIC fraud.

46. Mr Holland sought to persuade us that the CJEU in *Mahageban* imposed a temporal constraint in respect of the connection to fraud and that the objective factors must demonstrate an infringement or fraud at an earlier stage of the supply sequence leading to the goods being offered to the taxable person. We do not agree. The Court of Appeal made clear in *Mobilx* (at 62):

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

47. We noted the passage highlighted by HMRC at paragraph 47 of *Mahageban* which was not addressed by the Appellant and in which it was stated (emphasis added):

"By contrast, it is incompatible with the rules governing the right to deduct under that directive…to impose a penalty, in the form of refusing that right to a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud committed by the supplier, or that another transaction forming part of the chain of supply prior or subsequent to that transaction carried out by the taxable person was vitiated by VAT fraud…"

48. We were wholly satisfied that any seeming temporal restriction in *Mahageban* arose from specific facts with which the CJEU was concerned and that no such restriction was laid down as a principle with a view to altering the test in *Kittel.*

49. Having already concluded that the cases of *Mahageban, David* and *Toth* are fact specific, we did not accept Mr Holland's submission that there is a need for a taxable person to be in possession of information or material which arouses suspicion that a fraud has been committed at the time or before the transaction was entered into and as such due diligence could not be a requirement imposed on a taxable person until such material was proven. To apply such a test would be, in our view, to *"over-refine"* the test set out by *Kittel,* a matter which Moses LJ cautioned against in *Mobilx.*

Furthermore, to impose such a rigid test would not only alter the test in *Kittel* but would make any assessment of "knew or should have known" an impossible task; if no such material existed and therefore there was no requirement for the taxable person to carry out due diligence, there would be little evidence upon which the Tribunal could assess whether the Appellant had the requisite knowledge or means of such knowledge.

50. We accepted and adopted HMRC's submissions on this point; we agreed that HMRC were not attempting to transfer its investigative obligations onto the Appellant in this case, that the CJEU had simply demonstrated that due diligence cannot be a pre-requisite for exercising the right to deduct and that a strict liability approach is unacceptable.

51. We have set out Mr Holland's submissions as to the defects in the "only reasonable explanation test" as it was referred to, set down by the Court of Appeal. First we should note that we do not accept that the Court of Appeal in *Mobilx* set down any additional or refined test but rather the wording is a logical approach to the Kittel test in assessing the issue of knowledge or means of:

"82. But that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. As I indicated in relation to the BSG appeal, tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud."

As summarised in *Brayfal* by Lewison J summarised:

"In answering the factual question, Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focusing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in Kittel, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was."

52. We rejected Mr Holland's submissions on the issue of reasonable explanation. Case law has made clear that Tribunal's should apply caution in assessing the knowledge of an Appellant and have regard to matters which would be within his knowledge as distinct from that that would not. In applying the guidance given by Lewison J and taking into account circumstances at the relevant time, we did not accept that in assessing whether the only reasonable explanation for the transactions was connection to fraud can only be judged ex post facto and by reference to extrinsic facts outside of the Appellant's knowledge.

53. Similarly we rejected Mr Holland's further submissions on the point. In our view, each case must be decided on its own facts. There may be cases in which it is apparent from the transaction itself that the only reasonable explanation is something

other than to carry out a commercial transaction. Furthermore, we were wholly satisfied that taking into account the circumstances in which the transaction took place was the correct approach in law and in accordance with the test in *Kittel* and analysed in *Mobilx*; to fail to do so would, in our view, render any assessment artificial as explained by Clarke J in *Red 12 Trading Limited v HMRC* [2009] EWHC 2563 (Ch) at [84]at paragraphs 109 – 111:

"Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and 'similar fact' evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.

Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them".

54. Our approach to the issue was therefore to recognise that, while we must consider the merits of the individual transactions, we should not view each transaction in isolation. We decided that the surrounding circumstances of each transaction and the totality of the deals were relevant considerations and were cautious to ensure that in considering the knowledge of the Appellant we only took account of information known at or during the relevant period. We were careful when considering the information provided in witness statements as to the general mobile phone market or opinions provided by HMRC officers as to MTIC frauds, and we did not attach any significant weight to evidence established with the benefit of hindsight.

Issues

55. There was no dispute between the parties as to the issues to be determined in this case. On behalf of the Appellant, Mr Holland accepted that there had been a fraudulent tax loss. The issues remaining for the Tribunal to determine are:

- Were the Appellant's transactions connected to the fraudulent tax loss; and
- If so, did the Appellant know or should it have known of such a connection.

Undisputed Background Facts

56. The Appellant was incorporated on 15 April 2003; the registered address is 460 Green Lane, Palmers Green, London and the nature of its business was recorded at as "other non-store retail sale" and "other business activities". The directors of the Company at 6 July 2007 were as follows:

- Mr Constandino Costas appointed from date from inception and was shown as managing director;
- Mr Lucas Agathocleous, also Company Secretary, appointed on 5 September 2005; and
- Mr John Alexandrou, appointed on 22 September 2005.

Mr Costas, Mr Agathocleous and Mr Alexandrou each held 33% of the shares.

57. Mr Agathocleous is also a director of the following companies:

- Official Trading Ltd;
- Cronos Watches Ltd; and
- Property Services Ltd.

58. Mr Costas became a director and the company secretary of Official Trading Ltd on 18 October 2008. On the same date Helen Agathocleous resigned as company secretary of the same company.

59. On 20 July 2009 a Companies House search showed that Mr Alexandrou is also a director of ABC World Ltd.

60. Mr Costas applied for the Appellant to be VAT registered on 18 June 2003. The VAT1 declared the main business activity as "the sale of jewellery from a shop" and the estimated turnover for the following 12 months was £200,000. The Appellant did not expect to receive regular VAT repayments, no taxable supplies to other EU member states were expected over the next 12 months and the company would buy goods to the value of £20,000 from the EU in the same period.

61. The Appellant was registered for VAT with effect from 5 July 2003 with returns submitted on a quarterly period. On 13 April 2004 Mr Costas requested that returns be

submitted on a monthly basis. The business activity was confirmed as that of a retailer of jewellery to the public and the reason given for the request to change return periods was that the company intended to sell watches and fine jewellery to EC and non-EC countries and a repayment situation was envisaged. On 22 April 2004 HMRC refused the request.

62. On 22 September 2005 Mr Costas requested an amended VAT certificate to reflect DDJ's intention to import and export mobile telephone cameras, iPods and accessories to EC and non-EC countries under the trading name of DD Trade. HMRC refused to change the company's trade classification on the basis that there was no evidence provided to HMRC of the intention to import and export electronic goods or mobile phones at a meeting with the Appellant on 17 October 2005. At the meeting Mr Costas and Mr Agathocleous told HMRC that they had used the IPT and IGC websites to see what goods were available but as long as the company's VAT certificate remained as jewellers other companies would not trade with the Appellant. They confirmed that the company's accountant had sent them a copy of Public Notice 726.

63. By letter dated 14 November 2005 the Appellant notified HMRC that it intended to proceed with importing and exporting electrical goods and HMRC would be notified of any future transactions.

64. On 16 November 2005 HMRC wrote to DDJ warning about the prevalence of MTIC fraud in its trade sector and enclosing a copy of PN726. The letter requested that DDJ verify the VAT registration numbers of its trading counterparties with HMRC's Redhill office.

65. On 21 February 2006 HMRC Officer Ross visited the company. The visit note recorded that DDJ had purchased mobile telephones from a company called Shelford Trading and sold them to a French company called France Affaires.

66. The Company's turnover from the period 09/05 to 06/07 is set out in the table below:

Period	**Turnover (£)**
09/05	24,102
12/05	282,507
03/06	653,838
06/06	2,115,985
09/06	3,036,244
12/06	83,690

03/07	27,617
06/07	26,273

67. Of the declared turnover of £6,952,341 between 5 July 2003 to 30 June 2009 £5,865,375 was the result of trading in mobile telephones. 84% of the turnover was achieved in transactions that took place on 6 days: 8 December 2005, 30 March 2006, 9 June 2006, 27 June 2006, 22 September 2006, 28 September 2006 and 29 September 2006.

68. On 27 November 2006 DDJ was notified by HMRC that verification of its transactions in the period 09/06 would be carried out. By letters dated 20 February 2007, 5 March 2007, 31 December 2007 and 11 January 2008 HMRC indicated to the Appellant that the deals had been traced back to a tax loss via the contra-trader Optronix.

69. DDJ was notified of HMRC's decision to deny input tax in the deals making up the period 09/06 repayment claim by letter dated 9 September 2009. On 30 September 2009 DDJ requested an independent review. By letter dated 6 November 2009 the Appellant was informed that following a review, the decision was upheld.

Transactions connected to fraudulent tax losses

70. The table below sets out the deals chains involving the Appellant which form the subject of this appeal.

Deal No/ DDJ Invoice No	Deal Chain	Deal Chain	Deal Chain	Deal Chain	Deal Chain	Deal Chain	DDJ Purchase Price (£)	DDJ Sale Price (£)
1/7	Techbase Consultancy (PL)	Northcom Handels GmbH (AT)	Optronix Ltd	DDJ	EC Trading APS	Kima SRO (CZ)	174.00	182.50
2/8		Northcom Handels GmbH (AT)	Optronix Ltd	DDJ	EC Trading APS	Kima SRO (CZ)	240.00	252.00
3/9		Northcom Handels GmbH (AT)	Optronix Ltd	DDJ	EC Trading APS	Kima SRO (CZ)	158.00	166.00
4/10		Northcom Handels GmbH	Optronix Ltd	DDJ	EC Trading	Kima SRO	359.00	377.00

		(AT)			APS	(CZ)		
5/11	Kima SRO (CZ)	Northcom Handels GmbH (AT)	Optronix Ltd	DDJ	EC Trading APS	Kima SRO (CZ)	358.00	376.00
6/12	Techbase Consultancy (PL)	Northcom Handels GmbH (AT)	Optronix Ltd	DDJ	EC Trading APS	Kima SRO (CZ)	399.00	419.00
7/13	Techbase Consultancy (PL)	Northcom Handels GmbH (AT)	Optronix Ltd	DDJ	EC Trading APS	Kima SRO (CZ)	201.00	211.00

71. There was no challenge to the chains of supply traced by HMRC. Below we set out an overview of the companies which HMRC submitted connected DDJ to a fraudulent tax loss.

Optronix Ltd ("Optronix")

72. HMRC Officers Camm and Batley provided witness statements which were not challenged and which set out the background to Optronix, the contra-trader in this case.

73. Optronix was incorporated on 13 July 2001 and registered for VAT on 1 September 2001. The sole shareholder in Optronix was Mitek Group Ltd.

74. Mr Malcolm Roach (Director and Company Secretary from 13 July 2001 to 16 January 2006 who was also a director of Mitek Group Ltd) applied for VAT registration on 31 August 2001. The main business activity declared was "electronic equipment distributor" and the company had an estimated turnover in the following 12 months of £300,000.

75. In December 2005 the Mitek Group of companies which included Optronix was taken over by Global Management Group Holdings Ltd based in the British Virgin Islands. The Mitek Group is the sole shareholder of Optronix and owns 1000 shares for the value of £1,000. The principal director of Optronix and the Mitek Group, Mr Malcolm Roach, resigned in January 2006. Imran Hussain and Bart Van Laarhoven were appointed as directors of the Mitek Group on 2 December 2005. The main contact at Optronix and the associated company Mitek Computer Components Ltd was David Donnelly who was described as the "consultant accountant" but was neither an employee or company official within any of the Mitek Group of companies. In June 2012 Mr Donnelly was convicted of conspiracy to cheat the Revenue between 1 January 2005 and 13 December 2006 in relation to his activities at Optronix and Mitek for which he received a sentence of 7 years 6 months imprisonment.

76. On 15 December 2006 as part of a criminal investigation, HMRC uplifted all business records for Optronix and Mitek Computer Components Ltd. On 12 and 22 January 2007 mail issued to Optronix by HMRC was returned by Royal Mail. HMRC officer Camm visited the principal place of business on 26 January 2007 and was unable to gain entry to the premises which appeared empty. There has been no further contact made by or on behalf of Optronix which is considered by HMRC to be a missing trader.

77. HMRC inspected the 05/06 return. It was established that Optronix had completed 29 transactions:

- 15 involved Optronix acquiring goods from a supplier in Sweden for a net value of £9,601,250. The goods, which were all mobile telephones, were sold to UK based companies for a net value of £9,661,250. The output tax due to HMRC was £1,690,718.75.

- 14 deals involved Optronix purchasing goods from UK based suppliers for a net value of £9,898,035 and despatching them to EU based companies for a net value of £9,997,625. The goods were CPUs and small, high value electrical items. The input tax due to Optronix on the purchase price of the goods was £1,732,156.13.

78. All 14 of the transactions in which goods were sold by Optronix to EU customers were traced back through UK supply chains to one defaulting trader: 3D Animations Ltd ("3D Animations"). 3D Animations was de-registered for VAT with effect from 7 June 2006 after an HMRC officer visited the premises on 1 June 2006 and was unable to gain access to the principal place of business. HMRC suspected that the company was not trading from that address. The Director's address supplied to Companies House was a building site under construction, the previous building having been demolished in March 2006. The Company Secretary could also not be traced at any addresses provided.

79. During the period 08/06 Optronix conducted 205 deals. 103 of those deals were purchased from UK suppliers and despatched to customers in the EU. The remaining 102 transactions were acquired from suppliers in the EU and sold to UK customers. Officer Camm noted that by trading in such a way, Optronix had been able to off-set its liability to HMRC where it acted as an acquirer and reduce any subsequent VAT repayment where it acted as a broker; commonly referred to as contra-trading. She noted that DDJ was the broker for 3 deals in June 2006 and claimed input tax of £348,827.50. For the period ending 05/06 Optronix split its outputs evenly: 49.78% zero-rated and 50.22% standard-rated. In period 08/06 the split was 50.51% zero-rated and 49.49% standard-rated. In addition, the company's imports and exports were of approximately equal value.

80. As a result of such trading in both periods the output tax and input tax almost cancel each other out. Officer Camm concluded that the transactions were part of a contra-trading scheme where the tax losses in the brokered deals were off-set against the acquisitions.

81. Officer Camm noted that in the period of 9 months following the takeover of the Mitek Group of companies in December 2005, Optronix's turnover increased from £1,200,000 in the 3 months ending 02/06 to £20,000,000 in the 3 months ending 05/06 and £115,000,000 in the 3 months ending 08/06.

82. In June and July 2006 HMRC undertook a programme of searches of heavy goods vehicles. Amongst the vehicles searched were tractor units purportedly transferring goods on behalf of Optronix. On 6 dates on which searches were carried out HMRC found that the vehicles were not carrying the goods expected, for example on 14 June 2006 vehicle PN03 AUR, purportedly carrying multi-media players was in fact carrying animal feed. Similarly on 29 June 2006, a vehicle purportedly carrying cameras contained shredded paper.

83. Further investigations by HMRC revealed that a shareholder of the Mitek Group, Mr Bart van Laarhoven, had links to the FCIB where he had been employed from 2001 to 2005, acted as marketing manager until 2002 and Vice President from 2002 to 2005. Mr Hyre, a director of Mitek informed HMRC that this connection had been used to obtain details of potential customers and suppliers.

84. Officer Camm concluded that Optronix was a knowing participant in an overall scheme to defraud the revenue and had acted dishonestly as a contra-trader.

85. HMRC Officer Batley provided a witness statement which detailed Optronix's 11/06 VAT period, for which it did not submit a VAT return. The information was obtained from deal logs submitted by Optronix and records uplifted by HMRC on 15 December 2006 during a criminal investigation.

86. Optronix had carried out 40 transactions of which 21 were acquisition deals, 14 were broker deals and 5 were buffer deals. Had a return been submitted, Optronix would have sought repayment of £20,428.37 which masked a throughput of VAT of £6,000,000 and outputs of £17,400,000. Optronix had offset input tax of £3,030,878.12 against output tax of £3,010,449.75.

87. The acquisition deals involved the purchase of mobile telephones from an Austrian company called Northcom Handels GmbH which resulted in net sales totalling £8,200,000 with output tax due on the supplies of £1,430,353.75. 20 of the deals involved 5 brokers, one of which was DDJ, who despatched the goods of which in 17 transactions EC Trading was the customer.

88. The input tax incurred on Optronix's 14 broker deals totalled £1,448,570.56 which was almost offset by the output tax due on the acquisition deals which totalled £1,430,353.75. All 14 of the transactions were traced back to defaulting traders: 10 to C Corp, 2 to Synergi-Tec and 2 to Keycomp.

89. HMRC Officer Nigel Humphries provided a witness statement outlining his analysis of the deal sheets for Optronix and 4 other alleged contra-traders: Exhibit Enterprise Ltd, IH Technologies Ltd, RVM Ltd and Lighthouse Technologies Ltd. The similarities found by Mr Humphries supported HMRC's contention that each company was operating as part of an overall scheme to defraud the Revenue.

90. The 5 contra-traders had only 6 EC suppliers and their acquisitions were sold by 32 brokers to 10 EC and 1 Dubai based customer. All of these customers also featured as EC customers in the contra-traders tax loss broker transactions. The tax loss chains of the 5 contra-traders also shared common defaulters.

91. Mr Humphries concluded that for the fraudulent scheme to have worked, each party must have been aware of the fraud in so far as knowing from whom to buy, to whom to sell and at what prices.

Defaulting Traders

92. There were 3 defaulters in Optronix's tax loss chain: The C Corporation Ltd ("C Corp"), Synergi-Tec Ltd ("Synergi-Tec") and Keycomp Ltd ("Keycomp").

C Corp

93. HMRC Officer Smith provided an unchallenged witness statement outlining the trading activities of C Corp.

94. C Corp was incorporated on 17 March 2006; the director was John Docherty and the company secretary was Apex Company Services Ltd. Mr Docherty applied for VAT registration on 21 March 2006. The VAT1 declared the company's main business activity as "web design I.T. training". C Corp was registered for VAT with effect from 3 April 2006 and de-registered with effect from 29 September 2006, which was subsequently amended to 31 October 2006 after additional trading was discovered.

95. On 28 September 2006 an attempt by HMRC to visit the company's principal place of business was unsuccessful as officers were unable to locate the company as the address belonged to Apex Company Services Ltd. Another trader provided officers with a mobile telephone number for Mr Docherty but the phone was permanently turned off.

96. Freight forwarder documents dated 3 and 4 October 2006 showed that C Corp had acquired goods from a Portuguese company, Silver Pound Trading LDA, and released them to PCB2 Ltd. The goods were ultimately released to Optronix who despatched them to France. Neither this transaction nor any other was declared to HMRC by C Corp despite the fact that 10 of Optronix's broker transactions in 11/06 were traced to C Corp.

97. On 21 August 2007 an assessment was issued against C Corp in the sum of £1,381,168, which included the output tax on the 10 sales invoices to PCB2 which were traced to Optronix.

98. On 10 September 2007 another assessment was issued to C Corp in the sum of £328,772.

99. As C Corp had an outstanding debt to HMRC of £1,709,940 a winding up order was made against the company on 30 April 2008.

100. On 25 November 2008 and 17 December 2008 further assessments were issued to C Corp in the sums of £151,202 and £1,978,179 respectively.

101. The total liability of C Corp to HMRC was calculated as £3,839,333.43. The assessments remain unpaid.

102. It transpired that Mr Docherty was imprisoned for a period of 5 years from 26 January 2006. When he was interviewed by HMRC officers, he stated that he knew nothing about C Corp and that a bag containing information including his identity had been stolen from him in 2005-6 whilst he was living rough. Consequently HMRC treated Mr Docherty's identity as having been hijacked.

Synergi-Tec

103. HMRC Officer Yeomans provided an unchallenged witness statement regarding the trading activities of defaulting trader Synergi-Tec.

104. 2 of Optronix's broker deals in period 11/06 were traced to the defaulting trader Synergi-Tec.

105. Synergi-Tec was incorporated on 4 March 2003 and traded under the name "Halo". From 4 March 2003 to 16 August 2006 the director was Nicholas Redman Cooper and the company secretary was Katrina Redman Cooper. From 15 August 2006 the director was Abubakar Kadir (a French citizen) and the company secretary was Sajid Ali.

106. Katrina Redman Cooper applied for VAT registration on 25 March 2006. The VAT1 declared that the company's main business activity was "sales of electronic goods and computers". The company was registered with effect from 1 April 2003.

107. In a telephone call on 23 June 2003 HMRC was informed that the trading activity involved the sale of miniature cameras to customers in the home security market. The sales were intended to be via mail order.

108. At visits on 24 May and 14 June 2006 HMRC officer Unwin noted that the business was performing poorly and the owners were trying to sell it. As a result of several accounting errors found in the company's records an assessment was issued in the sum of £6,119 on 16 June 2006. On 19 June 2006 Katrina Redman Cooper requested a VAT de-registration form from HMRC. The completed form received by HMRC stated that the company had ceased trading on 24 June 2006 and that no stock was held as at 27 June 2006.

109. On 26 June 2006 Katrina Redman Cooper requested that the assessment be written off as the company had been trading on a reduced scale. HMRC was informed that a buyer had been found and the VAT debt would be paid in full. De-registration action was suspended as a result. HMRC did not receive a Transfer of a Going Concern application from the company and the last VAT return filed was a nil return for period 08/06.

110. On 29 November 2006 HMRC became aware from freight forwarder documents that Synergi was acquiring mobile telephones from Silver Pound Trading LDA which were released to PCB2 Ltd. The documents revealed that one of the companies in the 4 transaction chains was Mitek Computer Components Ltd; the associated company of Optronix. On 29 September 2006 the Portuguese authorities de-registered Silver Pound Trading LDA from VAT as it was found to have an inadequate structure to have carried out its claimed business activity.

111. HMRC spoke to "Kadir" of Synergi on 29 November 2006 and requested that paperwork naming the company's suppliers be provided. The documents received showed that in 4 transaction chains Synergi had purchased from UK Company Jafton Ltd. The documents were dated 13 November 2006 however HMRC officers had visited Jafton's PPOB on that date and were told by the building administrator that she had never heard of the company. Consequently Jafton was de-registered from VAT as of 13 November 2006. Jafton's accountant sent a transaction listing for the company to HMRC which did not show any transactions with Synergi.

112. HMRC officers visited Synergi's premises on 3 January 2007 and were informed by the building manager that the company officials only visited the premises approximately once a month. A letter sent to Mr Kadir at his last known address was returned marked "not known at this address". The company was subsequently de-registered with effect from 15 January 2007.

113. On 4 April 2007 Synergi was subject to a compulsory liquidation with an insolvency debt of £5.1 million.

114. On 4 April 2007 an assessment was issued to Synergi in the sum of £298,200. The assessment was returned marked "no longer trading at this address". Subsequent attempts were made to visit Mr Kadir's residential address, which was found to be a hotel, and Mr Ali's address which was found to be an office block.

115. On 15 August and 11 October 2007 assessments were issued to Synergi-Tec in the sums of £201,604 and £17,153 respectively. Further assessments were later issued in the sums of £170,625 and £67,173. The assessments, which totalled £754,755, remain unpaid. HMRC estimated that the true scale of Synergi's default was in the region of £1,500,000. HMRC was informed by the Official Receiver that consideration was being given as to whether the directors were to be deemed unfit to manage a company. Synergi was wound up by Court order on 28 November 2007 and dissolved on 25 November 2008 following a petition by HMRC.

Keycomp

116. HMRC Officer Alabi provided an unchallenged witness statement outlining the trading activities of defaulting trader Keycomp.

117. 2 of Optronix's deals in period 11/06 were traced to Keycomp.

118. Keycomp was incorporated on 3 October 2005. It failed to file any accounts at Companies House and a Companies House report requested on 24 June 2009 showed

the company was in liquidation. Mr Saeed Shah was director from 8 December 2005 to 1 December 2006 and Mr Kwame Asiedu was company secretary from 8 December 2005 to 1 December 2006. On 1 December 2006 Mr Jamil Malik was appointed as director and Gazala Malik as company secretary.

119. Mr Shah applied for the company to be VAT registered on 23 February 2006. The declared main business activity on the VAT1 was "wholesaling electrical equipment/appliances." The company was registered for VAT with effect from 24 March 2006 following confirmation from Mr Shah that the company would not sell mobile telephones. A Companies House report showed the business activities as "agents in the sale of variety of goods."

120. On 6 November 2006 HMRC obtained freight forwarder documents which showed that Keycomp was acquiring mobile telephones from Silver Pound Trading LDA in Portugal and releasing them to PCB2 Ltd.

121. On the same date HMRC officers visited Mr Shah who stated that he had stared wholesaling mobile telephones, iPods and DVDs one week earlier which he purchased from Silver Pound Ltd who had an office in Southall. Mr Shah stated that he had a UBS Swiss bank account but could not provide details of it to the officers, subsequently stating that in fact the account was with Pacific Western Technologies Ltd and that he also had a Barclays account. Mr Shah told HMRC officers that Keycomp had not paid its supplier nor had it been paid and would not be able to pay its VAT liability. The records relating to 14 sales uplifted by HMRC officers showed that on 31 October 2006 Keycomp had a turnover of £5,400,000 net of VAT.

122. A Regulation 25 letter dated 7 November 2006 was issued to Keycomp which brought forward its VATR return due date from 31 December 2006 to 8 November 2006. The company failed to submit the return and was de-registered on 8 November 2006.

123. On 20 February 2007 an assessment was issued to Keycomp in the sum of £941,238 which related to the 14 deals shown in the records uplifted. By letter dated 27 November 2006 Mr Shah informed HMRC that all of the transactions had been cancelled and consequently there was no VAT liability. The letter by which HMRC requested evidence showing how the goods involved in the transactions were returned to Silverpound was returned undelivered and the cancellation notes submitted in support of Mr Shah's assertion were deemed by HMRC to have been fabricated. On 28 March 2007 HMRC received a letter from Practical Systems Solutions Ltd ("PSS"), an accountant registered at the same address as that held by Companies House for Keycomp. The letter stated that the company had found no trace of Keycomp. HMRC telephone PSS on 29 March 2007 and was told that the company did not have the Keycomp listed as a client and did not know either Mr Shah or Mr Malik.

124. On 23 July 2009 an assessment in the sum of £272,461 was issued to Keycomp in respect of the 2 sales invoices traced to Optronix. A further assessment was issued on 28 March 2008 in the sum of £178,875.01.

125. Keycomp went missing with the assessments remaining unpaid. Keycomp was wound up by court order on 16 April 2008.

Findings on whether there was a tax loss, whether the tax loss was fraudulent and whether the Appellant's transactions in 09/06 were connected with fraudulent VAT losses?

126. We accepted the unchallenged evidence that Keycomp, C Corp and Synergi are missing traders who had no intention of meeting their VAT liabilities and dishonestly intended to evade VAT.

127. We accepted that assessments for unpaid output tax were raised against Keycomp, C Corp and Synergi and that the tax losses, which remain unpaid, are the result of fraud.

128. There was no challenge by the Appellant to HMRC's tracing of the Appellant's transaction chains in 09/06 or to the trading method used by the contra trader Optronix in offsetting input tax claims against output tax which linked the clean chains to the dirty chains.

129. We were satisfied that Optronix, during the period with which we are concerned, acted as a contra trader with the intention of fraudulently evading VAT and that the contra chain trans actions which are the subject of this appeal formed a part of an overall scheme to defraud the public revenue.

130. We found the evidence compiled by Officers Camm and Batley compelling and we concluded that Optronix's role in both the clean and dirty chains was designed to fraudulently evade VAT and therefore it must follow that the transactions conducted by the Appellant involving Optronix, were connected to the fraudulent evasion of VAT and tax losses.

131. Officer Humphries' evidence provided a summary of the contra scheme which was not challenged. He concluded that the transactions had no apparent commercial substance and were organised in such a way that goods passed through the UK in 2 separate, but linked, sets of transactions; one which involved tax losses and one which involved VAT repayment claims. The scheme required the goods to be kept within the same small circle of traders in order to operate successfully and enable those organising the scheme to maintain control of the goods and the money. We accepted the Officer's evidence as fact save for the opinions expressed therein which did not assist us in determining the issues in this case. We also noted that Officer Humphries evidence was compiled with the benefit of hindsight and we therefore limited the weight we attached to it and simply found that it reinforced our conclusion that the whole series of transactions entered into by the Optronix and its trading partners was contrived as an overall fraudulent scheme.

Did the Appellant know, or should he have known that the transactions in this appeal were connected to fraud?

132. The principal evidence on behalf of HMRC came from the officer responsible for issuing the decision letter by which the Appellant's claim was refused, Mrs Arnold, who provided detailed reasons for HMRC's decision to deny the Appellant's repayment claim in her 4 statements dated 3 August 2010, 30 March 2011, 5 December 2012 and 11 February 2013. We will not simply repeat the contents of those statements but will summarise the salient parts together with the responses by the witnesses on behalf of the Appellant.

Awareness of MTIC fraud

133. The Appellant was issued with PN726 on 16 November 2005 and a pro-forma letter of the same date requested that the Appellant validate the VAT registration numbers of its trading partners with HMRC's Redhill office. Mrs Arnold noted that following the letter dated 16 November 2005 being issued, DDJ did conduct checks with Redhill which demonstrated an understanding of the contents of the letter.

134. HMRC also visited the Appellant on 17 October 2005 when officers spoke to Mr Costas who stated that Mr Agathocleous was the company official with MTIC knowledge and the Appellant's accountant Alex Michael & Co was also providing assistance. A checklist had been set up to demonstrate the Company's due diligence. A visit was also undertaken by HMRC on 21 February 2006.

135. Mr Agathocleous' witness statement explained that at the time of entering into the sector he*"did not have a general awareness of fraud within the mobile telephone industry"* although he accepted that he had received a copy of Notice 726.

136. In oral evidence Mr Agathocleous stated that he was aware that fraud existed in every industry and he believed he had carried out sufficient due diligence. He later stated (transcript 27/2/13 page 119): *"If I knew there was fraud in it I would not have gone into this industry"*.

137. Mr Alexandrou could not recall Notice 726 but confirmed that HMRC had sent a letter warning about the prevalence of fraud in the mobile phone industry but stated when asked if he had read it (transcript 28/2/13 page 32): *"it was a lot of words, sir, that I didn't – they were a bit too long for me to understand, but I knew the gist of what they were basically saying."*

138. Mr Alexandrou confirmed that he was aware of VAT fraud in the industry but he did not know how it worked.

Experience of the trade sector and Roles in the Company

139. HMRC relied on the limited experience of DDJ's company officers in wholesaling mobile phones: Mr Agathocleous had acted as a receptionist for Megtian, prior to which he managed 2 fashion retail shops, Mr Costas had no prior experience in the trade sector and Mr Alexandrou was previously a chef and salesman for a cosmetics company.

140. The roles of Mr Costas, Mr Agathocleous and Mr Alexandrou were unclear; Mr Agathocleous initially stated that Mr Alexandrou was to run the phone side but later stated that in fact he gave Mr Alexandrou targets to reach and dealt with the accounts and Mr Costas was also involved in the deals. Subsequently Mr Agathocleous stated that Mr Alexandrou carried out the deals on his own.

141. HMRC submitted that behind Messrs' Agathocleous and Alexandrou's use of "business jargon and buzzwords such as: "platforms", "business plan", "market share" etc." there was no real understanding as to how the mobile phone industry operated.

142. Mr Kinnear cross-examined Mr Agathocleous regarding the Appellant's claim in a letter to HMRC dated 31 March 2008 which contained a number of references to "our initial business plan" and "our business model" when in fact no such business plan existed

143. In oral evidence Mr Agathocleous explained that Mr Costas and Mr Alexandrou are family friends. He described the experience he had in wholesale as follows (transcript 27/2/13 page 53):

"Q. Did you have any experience in the retail of electronic goods?

A. No. Not in retail.

Q. I did not hear you.

A. Not in retail.

Q. Wholesale?

A. I had wholesale. I had partial experience because the sister company of Stacey Lord was Megtian and they had an office inside the premises where I was running Chricos(?), which was Stacey Lord, so I saw the bases, the platforms which they were working from.

Q. What do you mean by "the platforms"?

A. They had an office there that was running tradeside - well, wholesale of phones and commodities and I saw the platforms they were using, the IPT/ICB platforms, and the basic ethics of how they were running their business on that side, on that sister company.

Q. So your experience was that you worked in a shop in the same building as some other people who traded in mobile phones, is that correct?

A. That was my first experience, yes.

Q. Did you spend any time in the office, working on what you call the platforms?

A. I was the face of their first company, so partially I was the face of the second company, as in the sense of answering calls, et cetera.

Q. What sort of calls did you answer?

A. There would be, well, administration calls.

Q. Relating to what?

A. Relating to -- well, probably passing it on to the secretary. There was a secretary that worked in the premises that dealt with the trades, so I would pass the calls on. So if I answered a call, I would pass the calls on.

Q. So someone would ring the phone and they would say "I want to speak to Megtian", and you would say "Okay"; is that right?

A. Yes.

Q. So what experience did that give you in the wholesale of mobile telephones?

A. It gave me companies that they were trading with.

Q. So it gave you contacts; is that correct?

A. Yes.

Q. So you say that by answering the telephone you became aware of the types of companies that were buying and selling mobile phones?

A. Yes"

144. Mr Agathocleous stated that his role was to call companies on various websites *"to see what price demands they needed on which phones and try to source those phones"*. He did not find it unusual to look for a seller and purchaser on the same website.

145. Mr Agathocleous explained that Mr Costas had no background experience in trading mobile phones. Mr Alexandrou was invited to join the company as he had previous experience in sales, although not in the mobile phone sector (transcript 27/2/13 page 60):

"Q. So the business was effectively going to be built on your experience?

A. Yes, I would say so.

Q. So you all get together in or around September 2005. What was the plan?

A. The plan was to have a trade division that Mr Alexandrou would control and me and Mr Costas would progress with the jewellery side.

Q. So you and Mr Costas were going to deal with the jewellery?

A. Yes.

Q. Mr Alexandrou was going to deal with I think you said a trading division. Is that right?

A. Yes, ideally trade. Yes, because we had ideally trade --

Q. Doing what?

A. Trading electrical goods."

146. Mr Agathocleous told us that his role was to run the company's accounts and he would give Mr Alexandrou target mark-ups to achieve on sales of 4% to 5%. He overlooked the deals, which involved ensuring that (transcript 27/2/13 page 79):

"…the correct checks were done. I implemented the structure of the deals in the sense of what paperwork was required and as long as they were fulfilled I thought the transaction was correct".

147. Mr Agathocleous clarified that although he was in charge of the overall company, Mr Alexandrou was in charge of the phone deals (transcript 27/2/13 page 82):

"Q. So is all that you gave Mr Alexandrou then is the name of the website; is that right?

A. Yes.

Q. You said to him: "Here is the IPT website. There is plenty of people on there to buy and sell from. Get on with it."

A. Yes."

148. Mr Agathocleous could not explain why there was no business plan, stating (transcript 27/2/13 page 65) *"we were young guys looking to get into a market and that is how I saw it"*. In cross examination Mr Agathocleous was referred to a letter from the Appellant to HMRC which stated:

"In accordance with our projections, these funds were used within our initial business plan…However we found ourselves in a position where we were going to exceed the expectation of this business plan…As a consequence we took a calculated decision to acquire further funds to support this new venture as we had full confidence within our

business model. As a result of this, we presented our business plan to family members."

149. Mr Agathocleous went on to say that the business plan was (transcript 27/2/13 page 67):

"*we knew that we could supply Europe with phones because of currency and market values. Products were worth more in Europe so we knew that we could provide that, so I needed to find more phones to be able to export to Europe."*

150. Mr Agathocleous explained that currencies work against product and, for example if the euro is strong his stock is required. He agreed that all of the transactions in this appeal were conducted in sterling but stated:

"Q. So where was this currency fluctuation? That is my word….

A. I am not saying that, I mean, by us putting a currency price upon it in euros that it was a demand. I am saying that, for them, it was viable for them to buy from the UK.

Q. How did you know that?

A. Due to currency. Due to currency being strong. Due to the pound being weak against other currencies.

Q. If you were going to take advantages of currency arbitrage or fluctuation, you need to know when they are fluctuating?

A. You don't need to know. What I needed to know was that the product was worth X amount in Europe.

151. Mr Agathocleous was questioned more closely about currency fluctuations and he went on to explain that (transcript 27/2/13 page 69*) "it was not about currency fluctuation, it was about market value"*.

152. Mr Alexandrou explained in his witness statement that he had been working as a chef in August 2005 when his cousin, Mr Costas, ask him to join DDJ in a sales role. He initially started on a part time basis and continued working as a chef. He developed many trading contacts during that time and exhibited handwritten notes of conversations with trading contacts. He stated in his oral evidence that although he had no prior experience of mobile phone trading he (transcript 28/2/13 page 10): *"was a salesman that basically believed in himself and believed in the product…and I found my way round it"*.

153. He went on the trading platforms every day, telephoned potential trading partners and received calls from other traders looking to either buy or sell stock. Mr Alexandrou could not recall the precise details as to how the transactions which are the subject of this appeal arose but if Optronix offered stock to the Appellant, Mr

Alexandrou would post an advert on a trading platform saying *that " company had X stock to offer at Y price. I would then have received enquiries from potential customers and…negotiated the best deal possible for the Company."* At the time of negotiations, Mr Alexandrou stated he did not think about percentage margins but rather looked at the selling price and buying price and knew what profit the Company needed to cover its costs and give a decent return.

154. In cross-examination Mr Alexandrou confirmed that he did not speak to any manufacturers (transcript 28/2/13 page 13):

"Q. You say a middle man, but why didn't you contact the manufacturers to find out whether they would sell to you?

A. I didn't feel we were going to be doing that type of thing, in terms of inviting people into our store to sell them a contract phone.

Q. But what do you mean by that?

A. I.e. when you -- you might be on Vodafone yourself. You might decide to go to a Vodafone store and say, "I want to buy a phone off you. This is how many minutes I want to use up a month and how many text messages I am going to send."

Q. Mr Alexandrou, I may have the wrong end of the stick here, but Vodafone are not a manufacturer, are they?

A. Well, they are a network, yes.

Q. Quite different to a manufacturer. Vodafone do not manufacture mobile phones, do they?

A. No, they don't, no… I have that wrong. You are absolutely right, they don't, yes."

155. When asked about authorised distributors, Mr Alexandrou stated (transcript 28/2/13 page 16):

"*Q. Here is a direct question for you then. Do you know what an authorised distributor is?*

A. I.e. Optronix? Are we speaking about that?

Q. I am asking you. Do you know what an authorised distributor of mobile phones is?

A. Someone that sells mobile phones, right?...

Q. -- listen to the questions and answer them. Do you know, yes or no, what an authorised distributor is?

A. The answer is it's somebody that sells mobile phones, right?

Q. That's a good start. What position do they take? What is their function?

A. They sell mobile phones.

Q. Who were they?

A. They could be companies that sell mobile phones. They could be companies that sell mobile phones to anybody, different companies.

Q. You have absolutely no idea how the industry in which you were carrying out millions of pounds' worth of trades worked, did you, Mr Alexandrou?

A. Of course I did.

156. As regards the roles of his fellow directors, Mr Alexandrou stated in oral evidence that Mr Costas was a silent partner regarding the mobile phone side of the business but was the face and voice of the jewellery aspect of the company. Mr Agathocleous dealt with the accounts.

157. Mr Alexandrou explained that the profits were made by buying in the UK and selling the goods to Europe as the EU purchasers saved money due to the exchange rate at the time. Mr Alexandrou was referred to the expert report of Mr Taylor which was not challenged and in which it was stated that *"the actual currency fluctuations throughout 2006 are sufficiently stable that the effects of them can be dismissed for the purposes of handset distribution"*. Mr Alexandrou was not aware of the report nor was he aware that Nokia had a fixed price for its phones throughout Europe.

Due Diligence

158. Mrs Arnold set out the due diligence provided to HMRC by the Appellant in respect of its customers and supplier.

159. The due diligence on Optronix was carried out by a company called Veracis which, by covering letter dated 15 June 2006 addressed to Mr Costas, provided an undated letter of introduction and a due diligence report together with enclosures. Mrs Arnold noted that Optronix's letter of introduction made no mention of mobile telephones which seemingly the Appellant did not query:

"Optronix Limited is a manufacturer of its own branded computer components, peripherals and personal computers…Optronix Limited wishes to expand its product portfolio to include a range of non Optronix products such as hard drives, CPU's and memory."

160. Mrs Arnold also highlighted that although the visit to Optronix by Veracis took place on 8 June 2006, the report was sent to DDJ by letter dated 15 June 2006. The

first deal undertaken with Optronix which had a value of £661,290 was 9 June 2006. HMRC submitted that the Veracis report had no impact on the Appellant's decision to trade with Optronix

161. Further features of the due diligence report highlighted by Mrs Arnold included the estimated £200 million turnover for 2006 as compared to the £1.25 million made to 31 March 2005, the fact that 9 employees assigned to Optronix were under the payroll of Mitek Group, that the company had only traded in mobile telephones for 2 – 3 weeks and market prices were established by telephoning customers, checking trade websites and comparing quotes each morning. The report detailed 2 negative indicators; the company's limited experience in trading mobile telephones and the fact that it had not traded for long enough in that sector to build up a history of tax compliance.

162. Optronix had also provided a trade application form that they had completed for a company called Late Editions Ltd. The form gave Mitek Computer Components Ltd as a reference, a company confirmed by Veracis to be the sister company of Optronix.

163. The Appellant's due diligence in respect of EC Trading consisted of a print out from the IPT website and a Veracis report. HMRC noted that the Appellant produced no evidence as to when the report was obtained and it therefore remains unknown whether the report had any effect on the Appellant' initial decision to trade with EC Trading. The report included a reference from Jyske bank which was provided by the director of EC Trading and which was not verified. HMRC also noted that much of the documentation annexed to the report was in Danish and had not been translated. A credit report showed that the business was newly established which appeared at odds with the director's assertion that the company had been trading for 3 years.

164. The report outlined that the estimated turnover for 2006 was £2 million per month and that the company had traded from its address for 8 months with Director Mr Olin, 2 full time staff and 2 part time employees. Goods were sourced worldwide each day via IPT and ICB websites, site visits were not undertaken nor were trade agreements in place. Mrs Arnold noted that the report did not highlight any negative indicators despite the fact that no site visits were undertaken and no written agreements of any kind existed.

165. HMRC contended that the due diligence undertaken by the Appellant was casual and lax; there was insufficient financial information regarding trading partners from which the Appellant could assess the financial stability or otherwise of those with which it traded. It was HMRC's case that the Appellant's due diligence was no more than "window dressing", carried out to meet the standards set out in PN726 rather than to verify the authenticity of the Appellant's trading partners.

166. In a letter to HMRC dated 5 December 2006 Mr Costas stated:

"We embark on a complete risk assessment by way of undertaking Due Diligence Checks and by following your suggested Section 726 Checklist prior to trading with other organisations. We have carried out this risk assessment for every trade we have

accepted. As yet, this method has not failed us and we pride ourselves on the efficacy of our system…"

167. In February 2007 Mr Alexandrou confirmed to HMRC that the Appellant complied with "How to spot missing trader fraud" requirements and undertook due diligence at substantial expense. Mr Alexandrou also stated *"…we faxed an "Intent to Trade" document to your offices and a response was received stating that Optronix Limited was a safe company to trade with. It was therefore reasonable for us to draw the obvious conclusion that we were able to trade with the company as we had been given your approval…"*

168. In oral evidence Mr Agathocleous stated that he did not carry out due diligence but he had looked at that which was collated by Mr Alexandrou. He was aware that (transcript 27/2/13 page 84) *"there were basic checks we had to do, that I thought were correct: Company House checks, VAT registration checks"*. Ultimately it was Mr Alexandrou's decision as to whether a transaction was entered into. He saw PN 726 as a guide as to the type of information required by HMRC to make due diligence correct.

169. He stated that the Veracis report had been obtained on Optronix with a view to trading with the company although he later clarified that the idea of getting the report came after the decision to trade with Optronix. He had looked over the report which was commissioned by either Mr Costas or Mr Alexandrou. The report appeared fine to Mr Agathocleous who did not see any issues arising from it. As regards Optronix's limited experience in mobile phone trade, Mr Agathocleous took the view that this was a similar position to that of the Appellant.

170. In his oral evidence Mr Alexandrou stated that he did not visit EC Trading as the Veracis report was an independent company which vouched for the company. He regularly spoke to a male from EC Trading who was fluent in English and he was aware that the company traded in electronic goods although he did not know if it was a wholesaler or retailer.

171. Regarding Veracis, Mr Alexandrou stated that it was convenient and less expensive to obtain a report from a professional body. In respect of the report on Optronix which followed a visit to the company on 8 June 2006 Mr Alexandrou stated that it was simply a coincidence that the date on which the visit took place was the same as the first reference to Optronix in the Appellant's log of contacts exhibited as part of the Appellant's evidence. Mr Alexandrou suggested that the author of the Veracis report may have visited Optronix independently of the Appellant's instruction (transcript 28/2/13 page 137):

"I hear what you're saying, however, couldn't it just be that Veracis does a job, I was doing a job, but it's a coincidence that he went on that day, 8 June, the first day that I Had spoken to Optronix, and done his due diligence checks and had the information? Is that not possible?

Q. Are you saying then that he has gone on the 8th to visit Optronix, not instructed by you?

A. I can't remember when I instructed him but I'm saying could that not have happened, what I'm saying?

Q. I'm trying to work through your scenario. You are saying that he goes on the 8th to visit Optronix, he was not instructed by you?

A. It quite clearly states he went on the 8th, yes.

Q. On exactly the same day you receive the first ever contact from Optronix?

A. I contacted them, yeah, along with many other companies. Yes.

Q. Then the next day you ring up Veracis and say, "I need a report on Optronix"?

A. Okay.

Q. What did he say, "Knock me down with a feather, Mr Alexandrou, out of all of the companies in all of the country you will never believe how lucky you are, I was there yesterday"?

A. I don't get -- so what? He is doing a job to provide people with information, he is bound to have a database of information.

172. Mr Alexandrou did not have any concerns about the matters set out in the Veracis report; he took the view that Optronix was a company in a similar position to the Appellant *"trying to get involved in a market where they saw there might have been a profit involved"*. In order to have raised concerns, Mr Alexandrou said the report would have had to contain (transcript 28/2/13 page 142):

"*Something, well, pretty serious in terms of, you know, they have never traded in anything electrical, I don't know, been declared bankruptcy or been liquidated or, I don't know, something a little bit more that there was something wrong going on. By them saying that they have been running for five years and they were trying to spread their wings not into the electrical market because they were obviously involved in that, they were just getting involved in the mobile phone industry.*

173. In respect of the Veracis report on EC Trading, Mr Alexandrou explained that the report was based on a visit in March 2006 which was not made at the Appellant's request (transcript 28/2/13 page 145):

"Q. And you didn't think it was odd that Veracis were able to send you a report that had already been prepared?

A. No, because he has built a database. I doubt he could travel to every company every single day of the week and verify every single company that's out there, he would probably do it over a period of year and hold the information for year in year out.

Q. But if you look at the top left-hand corner of page 74 it says: "Privileged and confidential prepared for the purposes of obtaining legal advice." So do you think it would be right for somebody from Veracis to go and visit EC Trading at the instruction of someone else and then flog the report to you?

A. I don't think -- I think he was using the platform as well where people were advertising or somewhere where EC Trading was advertising their company and he may have contacted them to go down there."

174. Mr Alexandrou could not recall when he had obtained the report of EC Trading. He stated that he did not have a clear understanding of some of the contents of the report, such as the credit worthiness. An invoice was produced during the hearing which Mr Alexandrou stated was from Veracis to the Appellant in respect of the reports provided. It was dated 4 July 2006 and contained a number of errors such as misspelling Optronix for which Mr Alexandrou could provide no explanation.

Movement of goods, Payments, Contracts and legal title

175. Mrs Arnold found the lack of any formal written contracts between DDJ and its trading partners unusual of a trader undertaking deals of such high value and the payment terms set out on the purchase orders, pro forma invoices and invoices were effectively ignored. Mrs Arnold highlighted that in the absence of clear written terms and conditions, it is impossible to identify which party would be liable if goods were lost or stolen or with which trader title lay. In cross examination Mrs Arnold accepted that she was unaware as to whether legitimate grey market traders entered into formal written contracts.

176. Furthermore none of the CMRs made reference to either Optronix or Northcom; for example in deals 1 to 4 the Appellant's purchase orders to Optronix show the shipping address as AFI Logistique in France. In contrast, the outgoing CMRs refer to both DDJ and EC Trading and show that the goods were "shipped on hold". Eagle Logistics was the carrier for all deals. An unannounced visit was made by HMRC to Eagle Logistics principal place of business on 23 September 2006 whereupon the unit was found to be locked and the shutters down. On 26 September 2006 one of the company's vans was stopped on entry into the UK. The driver said that the job had been cancelled and the van was empty. He stated that the van had also been empty when it left the UK. This was the same vehicle purportedly used in DDJ's deal number 2 on 23 September 2006.

177. Mrs Arnold noted that the goods were shipped to France between 23 September 2006 and 5 October 2006 and according to DDJ's paperwork AFI were not authorised to release the goods until sometime later. However the Appellant's release notes post-

dated those of its customer EC Trading, which appeared to have released the goods immediately and before it had made payment to DDJ or received title, although in cross examination Mrs Arnold agreed that she could not say whether this was known to the Appellant or not.

178. In 3 of the deals payment was received by the Appellant from EC Trading on 8 November 2006 and made by the Appellant to Optronix on the same date. In 1 deal payment was received by the Appellant on 8 November 2006 and made by the Appellant to Optronix on 10 November 2006. In the remaining 3 deals payment was received from EC Trading on 4 October 2006 and made to Optronix on 18 October 2006.

179. The Appellant's invoices stated *that "All products remain the property of DD Trade until full payment is received"*. Optronix's pro-forma invoices and their invoices show a payment due by date which is the same as the invoice dates which does not tally with the dates upon which payments were actually made by the Appellant. Mrs Arnold noted that as Optronix was not paid until the Appellant received payment from EC Trading it is questionable whether the Appellant ever in fact held title to the goods.

180. Mr Agathocleous' witness statement stated that, as in the jewellery/watch business, terms on invoices were varied orally. He was taken through the deal documents and asked to explain who had title to the goods and at what point it was transferred. He told us that until the Appellant made payment and the phones were released, Optronix retained ownership of the goods. Payment was due on the day the invoice was issued. On the same date the goods were sold by the Appellant to EC Trading and regarding ownership Mr Agathocleous stated (transcript 27/2/13 page 103):

"Q. These goods were not paid for…until well into October. So who owns the goods when you are invoicing EC Trading?

A. They are on ship on hold, are they not?

Q. Not at this stage. They are still in a warehouse in the UK.

A. They have been put on ship on hold to me until I make payment…

Q. Until who makes payment?

A. I make payment. They make payment to me.

Q. Ship on hold to where. Are you saying then that Optronix still own the goods; is that right?

A. Where a transaction would go is they -- I have made a purchase order. They have given me an invoice. I also had a purchase order from my supplier and from my

customer and once I have paid for the goods they are released to me and I have paid for the goods I would release them. So it is ship on hold.

Q. Why would you be allowed to ship the goods somewhere else if you do not own them?

A. They are still held under the same freight, still held under the same shipping company. There is no way that someone can take the goods without the instruction.

Q. We are going to come to it. That is exactly what they did do. It is not the same company. It is one company in the United Kingdom and one company in France, is it not. So…who do you say owned the goods?

A. At that stage it says it is me."

181. Mr Agathocleous went on to explain that the Appellant owned the goods at the time they were shipped but that Optronix still had "a hold" on the goods as they were shipped on hold. Mr Agathocleous later stated that technically Optronix owned the goods but the Appellant paid for shipment to the EU. In the same transaction EC Trading ordered AFI Logistiques to release the goods 5 days later to Kema in the Czech Republic. Mr Agathocleous stated that at that point the Appellant and Optronix still owned the goods which had not been released by the Appellant although he agreed that the documents showed that the goods had been released on the instruction to AFI Logistiques by its customer EC Trading.

182. Mr Agathocleous stated that in the event of non-payment by EC Trading he *"would have had to cancel the sale"* which was possible due to the fact that he had shipped the goods on hold and the was no binding contract with Optronix.

183. With hindsight Mr Agathocleous agreed that the deals were pre-arranged and explained that the Appellant had been an innocent dupe in the fraud.

"*Q. Is it your case that you were the dupe, the innocent dupe?*

A. Yes.

Q. The honest meat in the dishonest sandwich; is that what you are saying?

A. I am being told now my goods were released to someone else before I had released them.

Q. But apart from that, you do not really have any idea, do you, as to who owned the goods at any stage?

A. Goods are not anyone's until they are paid for. Is possession nine tenths of the law. If I have any in my possession are they mine, if I have not paid for them -- no.

Q. If possession is nine tenths of the law Kema had them by 22nd; did they own them if they had them. "

184. Mr Agathocleous was surprised that the goods were released when "*they was supposedly in my possession"* and stated that he had only been aware of this at the appeal hearing.

185. On the issue of title Mr Alexandrou stated in cross-examination that at the time a purchase order was issued he assumed Optronix owned the goods. The Appellant's invoice to EC Trading contained the words *"all products remain the property of DD Trade until full payment is received"* however Mr Alexandrou did not agree that this gave the impression that the Appellant owned the goods and he stated that ownership was still with Optronix. The goods were then shipped to the EU and Mr Alexandrou agreed that the Appellant had control over the goods at that point and that Optronix, which had not been paid by the Appellant, had granted credit over the goods, although the terms were never discussed. The goods were then sent to Kima in the Czech Republic on instructions from EC Trading. Mr Alexandrou stated that at that point Optronix still owned the goods as payment had not been made by either EC Trading or the Appellant and that the Appellant had not released the goods. Mr Alexandrou was referred to a release note from the Appellant to AFI Logistics in the UK directing release of the goods after payment was received by the Appellant but prior to it making payment to Optronix at which point, he stated, EC Trading owned the goods. There was a delay in the Appellant's payment to Optronix of 12 days regarding which he stated (transcript 28/2/13 page 118):

"Q. So on the account that you have just given us, Optronix owned the goods all the way up until you sent that release note?

A. No, until I paid for them. That is what I was always saying, until I paid for them.

Q. But on 6 October you have given the goods away. You have released them to EC Trading. You just told us that EC Trading owned them at that point?

A. Because EC Trading had paid me for them.

Q. Yes.

A. So I would have released.

Q. And you would have released to them?

A. I do not know why there was a delay between 6 October and the 18. I do not know why. What had happened in those 12 days, all I know is I would have, if I received the payment for them I would have released the goods. I do not know why this, it took 12 days to go through"

Mr Alexandrou subsequently stated that it was his responsibility to release goods but Mr Agathogleous was responsible for making payments.

186. In respect of the Appellant's role in the transactions Mr Alexandrou told us in his oral evidence that the Appellant added value by (transcript 28/2/13 page 168) *"adding money on top of it"* but he agreed that the Appellant did not make any alterations to the product to make it more valuable.

Grey Market

187. Mr Taylor, a Director of PwC, provided a detailed report which a number of generic topics, which can be summarised as follows:

- The level of demand for mobile phones in the UK and Europe;
- The supply structure of the mobile telecom industry and its evolution leading to the creation of a requirement for handset distribution;
- Unintended structural shortcomings which follow from demand characteristics and supply structure;
- The 4 grey market opportunities;
- Quantification of the revenue opportunity for UK based distributors in 2006;
- Profit and the margins of the handset distribution industry in 2006 for both UK based and overseas distributors and why the small profits available are not evenly distributed amongst competitors;
- Conclusions.

188. The statement of Mr Taylor was not challenged and for that reason we will not repeat the contents in any significant detail but rather we will summarise the salient points relevant to this appeal.

189. The 4 grey market opportunities are arbitrage, box breaking, forecast and dumping.

190. Arbitrage is the practice of using pricing differences to garner profit which can involve taking advantage of currency fluctuations to profit from buying and selling similar-priced products in different countries, or taking advantage of real differences in product pricing across different territories. Profiting from currency exchange movements in 2006 can be excluded as a possibility as the fluctuations were sufficiently stable that the effects can be dismissed.

191. Nokia has a carefully regulated pricing structure, the effect of which is to minimise price differentials, and hence arbitrage opportunities, between different countries. However there may be price differentials, and hence arbitrage opportunities within countries.

192. Mr Taylor considered the presence of a number of contra-indicators from which it could be concluded that a trader is very unlikely to be exploiting legitimate arbitrage opportunities. These indicators included trading in Nokia stock, excessive market share, insufficient detail on documentation and extended deal chains.

193. Box breaking arises when Non-Authorised distributors take advantage of differing handset subsidy levels in different countries. The presence of any of the following contra-indicators are sufficient, in Mr Taylor's view, to conclude that a trader is unlikely to be exploiting profitable box breaking opportunities: overseas sourced (non 3 pin plug) handsets, insufficient resources (i.e. too few employees or lack of significant workforce), excessive market share or generic product description.

194. Forecast failures arise where consumers differentiate between different products when making purchasing decisions. It requires a distributor to have ready access to stock and be able to supply handsets to a highly defined specification; although profits are potentially high they are normally only available to Authorised Distributors who already have the exact stock required. The presence of any of the following contra-indicators is sufficient to conclude that a distributor is very unlikely to be exploiting legitimate forecast failure: generic product description, lack of speculatively purchased stock or excessive market share.

195. Dumping involves distributors seeking to predict the level of demand for any given market product; if not accurately predicted they can be left with excess stock that cannot be traded for a suitable level of profit as the market price falls. Distributors therefore seek to mitigate the loss by dumping stock quickly into other markets at the new reduced price before it falls again. The presence of any of the following contra-indicators is sufficient to conclude that a distributor is very unlikely to be exploiting legitimate dumping opportunities: customer-initiated trading, no stock held by distributor, generic product description or excessive market share.

196. In oral evidence Mr Agathocleous initially stated that he could not be sure whether the Appellant had ever contacted distributors, although he subsequently felt sure that they had. When asked about distributors, he stated (transcript 27/2/13 page 93):

"*Q. Who were the authorised distributors?*

A. Sony Ericsson and Nokia.

Q. They are the manufacturers. Who were the authorised distributors?

A. I do not know.

Q. The truth is you do not have a clue, do you, about this industry?

A. I was naive in this industry, yes.

Q. You did not know -- in reality you knew nothing about it, did you -- did you?

A. I was new in the industry, yes.

Q. And Mr Alexandrou and Mr Costas knew even less than you, yes?

A. Possibly.

Q. So how was it you thought you were going to carry out multi-million pound deals?

A. I believed in my model.

Q. What model? What was the model?

A. It was a company that had divisions in it which – and markets that we could work on."

197. Mr Alexandrou told us that he believed the Appellant was operating in the grey market which he understood to be *"where you buy goods other than from Nokia"*.

Back to back and chains of supply

198. Mrs Arnold noted that the transactions were conducted on a back to back basis and DDJ was able to match exactly the amount of goods bought and sold and was never left with surplus stock. Furthermore there was no evidence that goods had ever been returned as faulty which would be expected given the quantity of goods traded.

199. In oral evidence to the Tribunal Mr Agathocleous accepted that it was clear from the fact that the phones had 2 pin plugs that they were imported from Europe. Mr Agathocleous did not accept that he must have been aware that the supply chain involved Optronix purchasing from an EU trader and the goods ultimately ending back in the EU, stating that he purchased from a UK supplier and could not have known the identity of its supplier. He did not think about the reason why the goods would begin in the EU and return to the EU.

200. Mr Alexandrou told the Tribunal he knew that the "middle men" in the supply chains included the Appellant, Optronix and EC Trading however he did not know if EC Trading was selling to an end user *"i.e. just a member of the public, or if he had 1,000 stores"*.

Turnover

201. It was the view of Mrs Arnold that the Appellant's turnover figures did not resemble those of an ordinary small business which had only started trading in mobile phones in December 2005. There is no obvious commercial reason why the Appellant's profit was so much higher than that of its supplier, customer and other traders in the chains. In cross examination Mrs Arnold accepted that if a business

moved into buying and selling high value products she would expect turnover to increase.

Loans and Banking

202. As regards the loans made by the parents of Mr Costas and Mr Alexandrou, Mrs Arnold formed the view that the documentation lacked commerciality. Mrs Arnold also noted that the loans would not have been sufficient to fund the deals and do not assist in understanding how the deals in December 2005 and March 2006 were funded. In cross examination Mrs Arnold accepted that the loans came from family members but noted that there was no indication as to when the capital would be repaid. She stated that she had seen many loan agreements during her time as an employee of HMRC although not many between parents and children and in those circumstances Mrs Arnold agreed that the loans were not "normal commercial loans."

203. Mr Agathocleous exhibited the loan agreements and evidence of mortgages taken out as security for the loans. His witness statement detailed that no security was provided for the loan as they are the parents of one of the company's directors. The loan has not been repaid and Mr and Mrs Costas have taken no action against their son.

204. Similarly there was no security provided in respect of the loan from Mr Alexandrou and no action has been taken by Mr Alexandrou in respect of the failure to repay the loan.

205. In oral evidence Mr Agathocleous explained that the interest on both loans had been waived and that approximately £40,000 had been paid back to Mr Costas' parents. He stated that he had believed that the Appellant had a market share from which it would make a profit but the venture backfired.

206. Mr Agathocleous was cross-examined about the Appellant's use of a Perpetual Wealth Bank in the Caribbean where it opened an account in October 2006. He stated that the Appellant had a problem with its NatWest account which was frozen without any explanation although there was no documentary evidence to support this. Due to pressure from customers and suppliers to fulfil deals, EC Trading and Optronix were asked by Mr Costas for bank recommendations. He researched the company and read its literature before opening an account.

207. Mr Agathocleous told us that following the transaction on 22 September 2006 he was anxious when payment was not received from EC Trading until 6 October and 8 November 2006 as he had no control over being paid (transcript 27/2/13 page 126): *"Obviously there was panic. Obviously"* but went on to state that the Appellant entered into more deals with EC Trading during that time (on 28 and 29 September 2006) as *"we had completed transactions with them before so the worry wasn't that intense." My main worry was when our account closed"* although he could not explain why he had never raised the issue with the NatWest account prior to his oral evidence.

208. Mr Alexandrou's evidence regarding the late payment by EC Trading differed; he stated in his oral evidence that (transcript 28/2/13 page 122, 123) "*on my side of things I was totally calm* I hear what you're saying but the thing is everybody got *paid. We paid, we were paid, we paid our supplier so everybody received their money, everybody received their phones, so there wasn't ever a complication there.*

209. In respect of the loans Mr Alexandrou state that he approached his parents as he felt confident in his ability to carry on making money. He was not using their money blindly and he felt there was no risk.

Inspections

210. A1 Inspections provided inspection reports for the Appellant. For a cost of 20p the inspection consisted of a box count, a full IMEI inspection and physical testing of 1 or 2 telephones from each box.

211. The inspection reports by AFI Logistique show the shipper, product, origin, amounts of units, the condition of packaging, manual and language. Mrs Arnold noted that the inspection of the condition of packaging was limited to the number of phones in a box and that there is no indication that any of the inner boxes were opened to allow examination of the actual phones.

212. HMRC officer White provided an unchallenged witness statement detailing covert searches made by HMRC of heavy goods vehicles in June and July 2006. The vehicles were searched whilst in transit from Dover to Calais. HMRC identified A1 Inspections Ltd as a company which had completed inspection reports for a number of the vehicles searched which proved to be empty or carrying items such as cardboard as opposed to the high value electrical goods indicated in A1's reports and the CMRs.

213. Mr Alexandrou was taken to an anomaly in the paperwork: in essence the Appellant's inspection report indicated that manuals for mobile phones in one transaction were in German and Spanish which Mr Alexandrou stated would have been discussed and agreed with EC Trading at the time of the transaction. An inspection report carried out by AFI Logistiques in France on behalf of EC Trading indicated that the manuals were in English. Mr Alexandrou explained that EC Trading did not raise this issue with him and queried whether there could be an error in the report.

IMEI numbers

214. The IMEI numbers provided by the Appellant were checked on HMRC's NEMESIS system. IMEI numbers were provided for all of the deals although Mrs Arnold noted that in deals 5, 6 and 7 there were fewer IMEI numbers provided than phones purportedly traded.

215. The checks carried out by HMRC revealed that in deal 1 of 33 batches checked, in 13 of the batches phones had been reported as lost or stolen prior to the deals taking place. In batch 11 one phone had been reported as lost or stolen on 24 September

2006, 2 days after the date of DDJ's invoice. In 26 batches phones had been scanned prior to the date of the deal.

216. In deal 2 of 25 batch reports in 3 batches phones had been reported as lost or stolen prior to the deals taking place.

217. In deal 3 of 36 batch reports in 12 batches phones had been reported as lost or stolen prior to the deals taking place. In batch 80 a phone had been reported as lost or stolen on 21 September 2006, the day before DDJ's sales invoice was issued. In 6 batches phones had been scanned prior to the date of the deal.

218. Deal 4 refers to the sale of 950 Nokia N93s however all IMEI numbers scanned refer to MP505s. Mrs Arnold was unable to say whether the IMEI numbers provided to HMRC were those scanned and therefore the goods traded were not as described by the Appellant or whether there had been a genuine error made regarding the IMEI numbers provided which were only 1 digit different to those which would have related to Nokia N93s.

219. In deal 5 2000 phones were traded but only 1304 IMEI numbers provided to HMRC. In the majority of batches the phones had never been scanned by HMRC before.

220. In deal 6 868 IMEI numbers were provided for the 1100 phones traded. In 9 of the 16 batches checked phones had been reported as lost or stolen prior to the deals taking place. In one batch a phone had been scanned by HMRC 10 times between February and July 2006.

221. In deal 7 none of the phones had been reported as lost or stolen prior to the date of the deal although those which had been scanned, had been so prior to the date of DDJ's invoice.

222. Mrs Arnold made the point that DDJ had failed to make the simple check of ensuring that all IMEI numbers were scanned despite paying for the service. In cross examination Mrs Arnold accepted that the Appellant would not have had access to NEMESIS and she was not able to say whether there was any way for the Appellant to check the IMEI numbers itself, noting that HMRC could not have provided the Appellant with any information as it was not in possession of the IMEI numbers.

223. Mr Agathocleous could not explain why fewer IMEI numbers than phones were provided. Mr Alexandrou stated that the numbers were obtained in order that the Appellant could keep a record of them to show the checks had been carried out. He assumed that the company which carried out the process would have checked the numbers using a database similar to NEMESIS and denied that the only reason the IMEI numbers were obtained was to placate HMRC.

Insurance of Goods

224. The Appellant provided insurance certificates showing that AFI Logistics Dubai provided marine insurance cover for each of the deals. In cross examination Mr Agathocleous explained:

"A. AFI had an insurance policy with myself.

Q. Did they. You had a policy for carriage, yes?

A. Yes.

Q. Why were you insuring the goods if they were not yours?

A. Well, they were going to be mine, were they not?"

225. Mr Agathocleous clarified that although the goods were never in his physical possession and his ownership of them may have been transferred to his customer the same day as he took title to the goods, insurance had been obtained to cover any eventuality.

Activities after DDJ

226. Mrs Arnold noted that Mr Agathocleous and Mr Costas are both directors of Official Trading Ltd which registered for VAT on 1 December 2012. The intended business activity was online retail of jewellery and watches. In VAT period 01/09 the company began trading in platinum which is another MTIC commodity, despite their awareness of MTIC fraud. As with DDJ, Official Trading Ltd achieved a significant turnover over a short period of time.

227. Mr Agathocleous explained in his witness statement that Official Trading Ltd is primarily an online website dealing with luxury watches, however it also sold platinum for a short period of time during which it had no problems with HMRC.

HMRC's submissions

228. HMRC invited us to consider the wider context of the Appellant's transaction chains and reach the conclusion that they were the product of orchestration by fraudsters as part of an overall scheme to defraud the Revenue.

229. HMRC queried why the Appellant was involved in the transaction chain unless it was a knowing party to the fraudulent scheme or whether it had been innocently duped. In support of its case that the Appellant knew of the fraud, HMRC highlighted the following features:

- The composition of each deal chain is almost identical;
- The transactions were carried out in a back to back basis and at a speed which is suggestive of contrivance;

- All of the transactions were traced back to fraudulent VAT losses;
- The goods cannot be linked to a manufacturer or authorised distributor;
- There was no commercial rationale to the transaction chains and the geography made no commercial sense;
- The patterns of Kima and Techbase appearing at either end of the chains taken together with the goods being despatched to the same freight forwarder is indicative of orchestrated carousel fraud;
- Failure by traders such as Northcom and Optronix to sell to parties known to it and thereby sacrifice potentially large profits is commercially inexplicable;
- Fixed mark-ups and the Appellant's method of calculating its mark-up are evident;
- Creation of profits without adding any value to the goods;
- There has been repeated scanning of IMEI numbers as a consequence of orchestrated circularity of goods;
- Certainty as to the success of its transactions;
- Failure to assess properly the commercial viability of trading partners;
- Window dressing exercise in terms of due diligence and inspection reports;
- Absence of basic knowledge as to how transactions took place, the market, payment terms, release and passage of title;
- Lack of credibility of Mr Agathocleous and Mr Alexandrou.

230. In the alternative HMRC submitted that the Appellant should have known of the connection between its transactions and the fraudulent evasion of VAT as there was no other reasonable explanation for the cumulative circumstances of the transactions. In summary, HMRC contended that in a sector rife with fraud the Appellant made large gross profits for doing nothing more than arranging the movement of goods across the English Channel despite the fact that those behind it had no experience of such transactions and no understanding of the market in which they operated. The deal documentation was inconsistent with the reality of the transactions and the Appellant not only failed to have regard to the checks recommended in Notice 726 but also failed to properly assess its trading counterparties.

The Appellant's submissions

231. In addition to the legal submissions relied upon, as set out earlier in this decision, on behalf of the Appellant Mr Holland submitted that HMRC's tracing of the supply chains in so far as it related to parties other than the Appellant, its supplier or customer was material about which the Appellant could not have known at the relevant time. The Appellant could also not have known about profit margins being achieved by its supplier, customer or any other trader in the supply chain.

232. The Appellant did not dispute that there was an international wholesale market in mobile telephones, however Mr Holland contended that HMRC failed to establish one distinguishing objective factor about the impugned deals which differentiated those deals from the international wholesale market and whereby the Appellant had the requisite knowledge. There is no evidence that the features of the Appellant's transactions did not also occur in the international wholesale market. The Appellant could not have known, without the benefit of being in possession of Mr Taylor's report at the relevant time, that the transactions did not take part in the international wholesale market.

233. The Appellant could not have known of the results of IMEI scans as only HMRC had access to NEMESIS. A1 kept a database of IMEIs for the Appellant to ensure that it did not buy the same phone on more than one occasion. A1 also confirmed that the correct model of phone had been inspected and existed, thus confirming that the transactions were carried out. The information obtained by HMRC in respect of A1 was not communicated to the Appellant in July 2006.

234. Insurance was obtained as the Appellant was in a position to suffer a direct financial loss and therefore cannot be deemed to be an objective factor from which requisite knowledge can be established.

235. Notice 726 made no mention of traders being refused the benefit of the right to deduct or circumstances in which the benefit could be lost. No account should be taken of Notice 726 as it was prepared by HMRC as an accompaniment to the joint and several liability legislation. As a matter of EU law it cannot have been the Appellant's responsibility to carry out the checks recommended in Notice 726 as HMRC cannot transfer its own investigative task to taxable persons.

236. The loans were not commercial as they came from family members and therefore not drafted in a commercial manner.

237. General warnings of fraud given by HMRC cannot amount to an objective factor pointing to fraud in the supply chains. HMRC failed to inform the Appellant that 95% of the industry was fraudulent as this was a matter not known to HMRC at the time and therefore could not have been known to the Appellant.

238. There is no evidence to substantiate an allegation of conspiracy nor was such a case pleaded naming parties involved and particulars.

239. Errors in the Veracis fee note do not point towards fabrication but rather human error.

240. That the Appellant opened an account with the Perpetual Wealth Bank and its customer also had an account there is not suspicious. The Appellant gave evidence that its NatWest account was frozen for a couple of weeks in the middle of October and EC Trading suggested that it should open an account with the Perpetual Wealth Bank, which it did.

241. There was no need for the Appellant to know manufacturers or authorised distributors as it did not trade in the white market; it traded in the grey market. The Appellant explained that EU purchasers wanted its stock due to the relative strength of the Euro against Sterling which was speculation and a question which should have been put to EU purchasers. HMRC did not adduce evidence that 2 pin charger phones in the UK could not play a part in the legitimate grey market.

242. HMRC submitted that for the fraud to work the Appellant must recover its repayment however the fraud has already been committed. The Appellant is not seeking to recover the ill-gotten gains from fraud but rather repayment of its input tax credits.

243. The Appellant's witnesses are not industry experts, economists or legally trained and therefore cannot be expected to have an understanding of concepts such as "insurable interest" or "passing of title". Given the lapse of time since the relevant transactions it is not surprising that the Appellant's witnesses could not recall certain events.

Decision

Findings of fact on whether the Appellant knew, or should have known, that its transactions were connected to fraud.

231. We considered the law, oral and written evidence of the witnesses and submissions of both parties carefully in reaching the following findings of fact.

Witnesses Credibility

244. We found Mrs Arnold to be a credible and reliable witness. We noted that she had not been involved throughout the extended verification process and her role had been to issue the decision letter in which the Appellant's repayment claim was denied. However we were satisfied that Mrs Arnold had conducted a thorough analysis of all aspects of this case and we accepted her evidence.

245. We found that the evidence of Mr Agathocleous and Mr Alexandrou did not withstand scrutiny, was unconvincing and on a number of occasions inconsistent. We bore in mind that a significant period of time has elapsed since the transactions which are the subject of this appeal were carried out but in our view the evidence of both Mr Agathocleous and Mr Alexandrou went beyond a recollection limited by the passage of time; rather it appeared to us that neither witness had any real understanding of the mobile phone industry or trade connected to it. We did not accept that a reasonable businessman would have so little understanding of the market generally or his role in

it. We were satisfied that neither Mr Agathocleous or Mr Alexandrou could be relied upon as a witness of truth.

Conspiracy

246. We considered the Appellant's submission that HMRC adduced no evidence to substantiate an allegation of conspiracy nor was such a case pleaded naming parties involved and particulars. We were satisfied that in applying *Kittel*, in order to be a participant there is no need for a trader at the time of entering into a transaction to know the details of a fraud. We do not accept that the detail of the fraud or the extent of the Appellant's knowledge require particularising; the very nature of fraud is designed to conceal knowledge and participants. In applying the *Mobilx* test we are satisfied that conspiracy is not something which HMRC must plead or prove and that the test which we must apply does not require a finding as to what details, if any, the Appellant knew of the overall scheme to defraud, but rather whether he knew or had the means to know that by entering into the relevant transactions it was participating in and thereby aiding a fraud.

Awareness of MTIC Fraud

247. Mr Agathocleous' evidence on this point was inconsistent and unconvincing and we found Mr Alexandrou's evidence that the words contained in Notice 726 were *"too long"* wholly implausible particularly when viewed against the evidence that it was Mr Alexandrou who was responsible for carrying out the deals. We were quite satisfied that the Appellant, through Mr Agathocleous and Mr Alexandrou, was aware was aware of the general prevalence and characteristics of fraud within the industry, and it was against this background that we assessed the nature of the Appellant's trading.

Experience of the trade sector and Roles in the Company

248. The oral evidence given by Mr Agathocleous and Mr Alexandrou was vague and unclear. Mr Agathocleous' evidence initially was that Mr Alexandrou ran the mobile phone side of the company but he later stated that he effectively overlooked the transactions and that Mr Costas was also involved in carrying out deals. Mr Alexandrou's evidence was that he carried out the transactions, Mr Agathocleous dealt with the accounts and Mr Costas took no part in the mobile phone side of the business.

249. We noted that none of the directors had any previous experience of mobile phone trading. We found Mr Agathocleous' evidence regarding his experience with Megtian did not withstand scrutiny and we were left with the clear impression that he had done no more than answer the telephone and pass messages on.

250. The oral evidence given by both Mr Agathocleous and Mr Alexandrou lacked credibility. By way of example, Mr Alexandrou's evidence that he believed in himself as a salesman and the product lacked any real meaning and did not explain how the Appellant appeared to enter into high value transactions without any knowledge or experience but with apparent ease.

251. We found the Appellant's explanation that it re-posted information on the IPT nonsensical. It lacked credibility that the Appellant believed that by posting information already present on the IPT website it could attract customers who could not find the original posting. That the Appellant failed to question how it could trade so successfully in such a way is implausible and we were satisfied that this was an indication that the Appellant was aware that it was participating in a contrived scheme (transcript 28/2/13 page 186):

"Q: I am just slightly confused and perhaps you might be able to help me on this, but doesn't that information come from the IPT in the first place?

A. It would come from the IPT, yes.

Q.: So you are re-posting information?

A. I am posting information that I have found on there, yes, but I've been verbally told exactly what it is and where it's -- how much of it there is.

Q: But those companies have already posted it themselves, haven't they?

A. I have found them on there, yes."

252. In our view the lack of experience combined with the absence of any business plan or understanding about the market was indicative of the contrived nature of the transactions and the Appellant's knowledge of that fact.

253. Mr Alexandrou claimed to have researched the mobile phone market however under cross-examination it was clear that he no understanding of the structure of the market. We noted that neither Mr Agathocleous nor Mr Alexandrou had any real understanding about manufacturers or authorised distributors. These are basic terms and ones which we would expect any legitimate trader operating in the industry to understand.

254. We rejected the evidence that profit was attainable due to currency fluctuations. Neither Mr Agathocleous nor Mr Alexandrou could explain with any clarity what they meant or how currency fluctuations impacted on the Appellant as a trader. Under cross-examination the evidence was wholly inadequate and demonstrated that neither witness could explain how currency exchange had any effect on their deals which were carried out in sterling. We also noted and accepted the unchallenged evidence of Mr Taylor who confirmed that currency fluctuations throughout 2006 were sufficiently stable to dismiss any assertion that profits came from currency exchange movements.

Due Diligence

255. The due diligence carried out by the Appellant lacked any substance. We formed the impression that the reports obtained from Veracis served no purpose other

than window dressing. Mr Alexandrou admitted that he did not understand credit reports and it was clear that the Appellant had not considered aspects of the report such as the fact that Optronix had only traded in mobile telephones for 2 to 3 weeks. Mr Alexandrou's evidence that in order not to trade the report would have had to contain something *"pretty serious"* lacked any credibility.

256. We also noted that the Appellant failed to query why Optronix's letter of introduction made no mention of mobile phones, a matter which in our view would have concerned any reasonable businessman seeking to protect himself from fraud.

257. The Veracis report on Optronix followed a visit to the company the day before the transaction was carried out. The oral evidence as to whether the report was obtained prior to the transaction was unconvincing and we were left with the clear impression that the report, and its contents, had no impact on the decision whether or not to trade with Optronix. The oral evidence as to how Veracis prepared its reports was unclear and demonstrated a lack of any understanding as to how Veracis operated which would not be expected of any reasonable businessman seeking to rely on the company to carry out its due diligence.

258. Similarly there was no evidence when the report on EC Trading was obtained and whether it was in Appellant's possession before the decision to trade was made. Even accepting that it was, as with the report on Optronix, the Appellant clearly had little regard for its contents such as the documentation annexed to the report which was in Danish and appeared not to have been translated.

259. We found as a fact that the Appellant's reliance on Veracis was an attempt to shift responsibility and that it failed to conduct any checks of substance on the company. We were satisfied that this was indicative of the Appellant's awareness of the contrived nature of its transactions.

260. The oral evidence that supported our conclusion that the Appellant relied on Notice 726 as a checklist to appease HMRC. Mr Alexandrou's assertion that *"…we faxed an "Intent to Trade" document to your offices and a response was received stating that Optronix Limited was a safe company to trade with. It was therefore reasonable for us to draw the obvious conclusion that we were able to trade with the company as we had been given your approval…"* was indicative of the Appellant's attitude that due diligence was about seeking HMRC's approval rather than a means of protecting itself against fraud.

261. HMRC invited the Tribunal to find that the invoice for the Veracis reports produced during the evidence was fabricated. We were not satisfied that there was sufficient basis for us to reach such a finding but we queried why the invoice had not been produced earlier. The invoice contained the following errors: Optronix was spelt "Optronics" and EC Trading APS was described as "EC Trading Ltd". In our view such errors were obvious and a matter which would clearly cause concern to any legitimate trader. We concluded that the Appellant's failure to either notice or query the mistakes was indicative of the fact that due diligence and the company upon which the Appellant relied were of no real concern to the Appellant.

262. We were satisfied that the due diligence obtained provided insufficient information from which the Appellant could meaningfully assess the financial viability of its trading partners and was carried out to meet the standards set out in Notice 726 rather than for the Appellant to satisfy itself as to the veracity of its customer and supplier. The fact that Mr Alexandrou did not even know whether EC Trading was a wholesaler or retailer was indicative of just how little the Appellant knew and its willingness to enter into such high value transactions on the basis of such limited knowledge was indicative, in our view, of the Appellant's knowledge that the deals were contrived.

Movement of goods, Payments, Contracts and legal title

263. There were no written agreements regarding matters such as shipping terms and responsibility for returns of faulty goods. In our view this was implausible for a legitimate trader seeking to minimise exposure to risk. The terms set out on purchase orders and pro-forma invoices were ignored and there was no evidence to support the assertion that terms were varied orally. In our view, any legitimate business involved in transactions of such high value would have recorded any terms agreed in order to protect itself.

264. The oral evidence as to title from both Mr Alexandrou and Mr Agathocleous was inconsistent. Mr Agathocleous changed his account as to who owned the goods on a number of occasions and we found his claim that the goods were shipped without a binding contract with the Appellant's supplier lacked credibility. We rejected his assertion that the goods belonged to the Appellant at the time they were shipped but that Optronix had *"a hold"* on the goods as implausible as was his explanation *that "goods are not anyone's until they are paid for. Is possession nine tenths of the law. If I have any in my possession they are mine"*.

265. Mr Alexandrou's oral evidence that Optronix owned the goods until paid was at odds with the Appellant's invoice to EC Trading which stated that the goods remained the property of the Appellant until payment was received. The meaning of the words on the invoice is clear and we found Mr Alexandrou's denial that they inferred ownership of the goods was an attempt to minimise evidence that clearly undermined the Appellant's case

266. In our view legal title is an issue crucial to any trader and a reasonable businessman would ensure that it was clear which party had legal title to the goods and at what point legal title passed. We did not accept that the term was beyond the comprehension of the Appellant; ownership of goods is an important and obvious feature where goods are traded and we did not accept that the Appellant required any specialist legal knowledge to understand such a basic concept.

267. We were satisfied that the lack of clarity or formal record regarding legal title was indicative of the contrived nature of the deals whereby legal title would never be in issue. We found the oral evidence relating to title extremely persuasive in that Mr Agathocleous was unable to explain how title passed and his lack of understanding

was obvious. In our view, the evidence laid bare the lack of commerciality of the trade in which the Appellant was engaged.

268. Mr Alexandrou exhibited a number of documents which he stated demonstrated the Appellant's record of identifying whether prices increased or decreased. The documents provided no assistance to us; it was unclear which company named on the document was a supplier and which was a customer and no quantities were recorded which made us question how Mr Alexandrou had matched suppliers and customers. The document also recorded some, but not all, of the Appellant's transactions showing that it had purchased at a higher price than offered by other companies which made no commercial sense and for which no credible explanation was provided by the Appellant.

269. We also noted that the specifications contained on the Appellant's documents were vague. Mr Alexandrou stated that he would have discussed such matters with his customer, for example the language of the phones' manuals, however Mr Alexandrou failed to give any credible explanation as to why EC Trading did not return goods to the Appellant or complain when their own inspection report confirmed that the manuals were in a different language to that agreed.

Grey Market

270. We found the unchallenged evidence of Mr Taylor provided limited assistance. The generic nature of the report did not lead us to any conclusions as to the knowledge or means of knowledge on the part of the Appellant but we were satisfied that the presence of a number of the contra indicators set out earlier in this decision confirmed that the Appellant was not exploiting a rational grey market opportunity.

Back to Back deals and chains of supply

271. The transactions took place on a back to back basis and there was no documentary evidence to show that Appellant was ever left with unsold stock. Whilst we found that this corroborated the fact that the deals were contrived as part of a scheme, we could not be satisfied that this fact, of itself, was sufficient to indicate that the Appellant knew or should have known that the transactions were contrived.

272. As regards the chains of supply, the Appellant was aware that the chain included Optronix, EC Trading and itself. The fact that the phones had 2 pin plugs was indicative of the fact that they came from the EU. That the Appellant failed to consider where the goods came from beyond its supplier or where the goods ended up was, in our view, a feature which indicated knowledge of the contrivance or, at the very least turning a blind eye to a feature which in our view any legitimate trader would have considered.

Turnover

273. We accepted HMRC's submission that the Appellant's turnover figures do not resemble those of an ordinary small business and we found as a fact that neither Mr Agathocleous nor Mr Alexandrou provided any credible explanation for this, nor did

they appear to have questioned the Appellant's success which was "too good to be true".

274. We were satisfied that the profits made for such little work and without adding any value to the product were indicative of the link to fraud, a fact about which the Appellant must either have known or should have known.

275. We rejected Mr Alexandrou's evidence that all deals were robustly negotiated on the basis that the Appellant obtained a mark-up of 5% in each deal irrespective of the make or quantity of phones. In our view this was implausible and in the absence of any documentary evidence to support the assertion that negotiations took place we were satisfied that the only reasonable explanation for the consistent mark-up was that the deals were contrived and the Appellant was aware that the price was pre-determined. Our view was strengthened by the handwritten notes exhibited by the Appellant (purporting to record prices at which goods were available) which for a number of deals in June 2006 recorded the price as the same as that paid.

Loans and Banking

276. The loan documents lacked commerciality but we accepted the Appellant's evidence that as the loans came from family members they should not be regarded as ordinary commercial loans. We noted that the loans were almost the exact amount required to cover the VAT deficit on the transactions and we concluded that the Appellant's willingness to risk so much when viewed against their lack of experience and knowledge of the trade was indicative of its knowledge that the deals were contrived.

277. The oral evidence regarding the Appellant's frozen NatWest account was information which had not been raised prior to the hearing and in our view was an attempt by the Appellant to provide an explanation for opening an offshore bank account. No documentary evidence was produced to support the assertion that the account was frozen and no credible explanation was provided as to why it was frozen. We noted that the offshore account was used to make payments on 8 November 2006 and that the NatWest account was used on 10 November 2006 which demonstrated that it was not frozen at that time. We found the evidence that EC Trading had been asked for banking recommendations unconvincing and we accepted HMRC's submission that the only reasonable explanation was that the offshore account was opened in order to conduct activities outside of the UK banking system.

278. The evidence regarding EC Trading's delayed payment to the Appellant was inconsistent; Mr Agathocleous asserted that there was *"panic"* contradicted Mr Alexandrou's evidence that *"I was totally calm"*. Despite having not been paid in excess of £1,000,000 by its customer the Appellant went on to conduct more deals with EC Trading. We were satisfied that the only reasonable explanation for entering into more deals when payment remained outstanding was that the Appellant knew that the deals were contrived; as Mr Alexandrou stated *"we paid, we were paid…so everybody received their money"*. In reality the Appellant knew there was no risk of not being paid.

Inspections and IMEI numbers

279. We were satisfied that the Appellant used A1 as a means to satisfy HMRC rather than any provide any meaningful protection against the risk of fraud. There was no evidence to demonstrate that the Appellant had made meaningful enquiries into A1 as a company and whilst we accept that the results of HMRC's covert searches of vans purported to have been inspected by A1 would not have been known to the Appellant, there was no evidence upon which we could be satisfied that the Appellant had considered the contents of the reports provided.

280. We accepted that the Appellant did not have access to the NEMESIS database and therefore would not have been aware of the results of the scans as set out by Mrs Arnold however there was no credible explanation as to why the numbers were obtained or what purpose they served for the Appellant. If the Appellant had considered the numbers at all, it would have been clear that there were fewer IMEI numbers than phones in certain cases. The fact that this was unknown to the Appellant was indicative of the fact that the numbers were not considered and in reality served no purpose other than to satisfy HMRC.

Insurance

281. We queried why the Appellant insured goods that would only belong to it for a limited period of time, given that once payment was received from its customer the Appellant immediately paid its supplier, however we were satisfied that insuring the goods was consistent with a trader protecting himself against risk and we did not find that this pointed towards any knowledge or means of knowledge on the part of the Appellant.

Activities after DDJ

282. We did not take into account the activities of Mr Costas or Mr Agathocleous after the period with which this appeal is concerned. The test to be applied in this case is whether, at the time of entering into the transactions which form the subject of this appeal the Appellant knew or should have known that its transactions were connected to the fraudulent evasion of VAT. On that basis, we concluded that any trading activity which took place subsequent to the deals with which we are concerned could not be indicative to the Appellant's state of knowledge during an earlier period.

General

283. It was clear that the Appellant failed to consider or query obvious features of its transactions which would have led to the clear indication that the transactions were connected to fraud. The type of questions which we would expect any reasonable businessman to have asked are set out in *Mobilx* (at paragraph 72):

"(1) Why was BSG, a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?

(2) How likely in ordinary commercial circumstances would it be for a company in BSG's position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone?
(3) Was Infinity already making supplies direct to other EC countries? If so, he could have asked why Infinity was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.
(4) Why are various people encouraging BSG to become involved in these transactions? What benefit might they be deriving by persuading BSG to do so? Why should they be inviting BSG to join in when they could do so instead and take the profit for themselves?" (§ 227)

284. We agreed with and had regard to the comments of Judge Bishopp in *Calltel Telecom Ltd v HMRC* [2007] UKVAT V20266 (at 52):

"…it is, we think, possible that a trader could have the means of knowing that, by his participation, he is assisting a fraud. Much will depend on the facts, but an obvious example might be the offer of an easy purchase and sale generating a conspicuously generous profit for no evident reason. A trader receiving such an offer would be well advised to ask why it had been made; if he did not he would be likely to fail the test set out at paragraph 51 of the judgment in Kittel*."*

285. We were satisfied that looking at the overall pattern of trading there were numerous objective factors indicative of the contrived nature of the transactions which were within the knowledge of Mr Agathocleous and Mr Alexandrou, for example the high value deals with previously unknown trading partners despite the Appellant's lack of experience, the movement of goods prior to obtaining legal title, the consistent profit margins and mark-ups made irrespective of the type and quantity of goods, the lack of standard contractual terms and absence of evidence of variation of agreed terms. The invoices and inspection reports provided limited detail of specification and bearing in mind that the Appellant did not take physical possession of the goods we concluded that attention to detail in documentation would be all the more important to any reasonable businessman.

286. We accepted the evidence of Mr Humphries that in order for an MTIC fraud to be work the scheme required the goods to be kept within the same small circle of traders in order to operate successfully and enable those organising the scheme to maintain control of the goods and the money. For the reasons set out above we rejected the Appellant's submission that it was an innocent dupe in the scheme and in the absence of any alternative reasonable explanation for the Appellant's involvement we were wholly satisfied that the Appellant, through Mr Alexandrou and Mr Agathocleous had the knowledge and, at the very least, the means to conclude that its transactions were connected to fraud.

Conclusion

287. We were satisfied that HMRC had established fraudulent tax losses and that there was an orchestrated scheme for the fraudulent evasion of VAT connected with each of the transactions which form the subject of this appeal.

288. We did not focus unduly on the issue of due diligence, and we took into account all of the surrounding circumstances in reaching our decision that the Appellant knew that each of its transactions were part of an artificial scheme. In doing so, we concluded that the Appellant, through Mr Agathocleous and Mr Alexandrou, had actual knowledge that the transactions were connected to fraud and that, by its purchases, it was taking part in transactions connected with the fraudulent evasion of VAT. We were also satisfied that the factors identified above would also support a finding of means of knowledge.

289. We found that some reasons carried more weight than others and we did not base our decision solely on one reason but rather the cumulative effect of our findings viewed in totality.

290. HMRC has proved that the Appellant's means of knowledge was such that the transactions fell outside the scope of the right to deduct input tax. Accordingly we found that the decision of HMRC to deny the Appellant's input tax was correct and is upheld.

291. The appeal is dismissed.

Costs

292. We direct that the Appellant is to pay HMRC costs of, incidental to and consequent upon the appeal, to be the subject of detailed assessment if not agreed.

293. 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.

J BLEWITT
TRIBUNAL JUDGE

RELEASE DATE: 28 August 2013