Appeal number
UT/2015/0156

Value added tax – input tax – whether transactions connected with fraud – whether First-Tier Tribunal conclusion procedurally unfair – whether appellant knew or should have known of connection with fraud

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

ULSTER METAL REFINERS LIMITED **Appellant**

- and –

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

Tribunal: The Hon Mr Justice Arnold and Judge Charles Hellier

Sitting in public at the Rolls Building, Fetter Lane, London EC4A 1NL on 29 June 2016

Hywel Jenkins, instructed by CTM Litigation & Tax Services, for the Appellant

Paul Taylor, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal from a decision of the First-tier Tribunal (Tax) (Tribunal Judge Jonathan Cannan and Mr John Adrian FCA) dated 2 June 2015 [2015] UKFTT 255 (TC). By its decision the First-tier Tribunal, which hereinafter we will refer to for brevity simply as "the Tribunal", dismissed the appeal of Ulster Metal Refiners Ltd ("UMR") against a decision of the Commissioners for Her Majesty's Revenue and Customs ("HMRC") to deny UMR entitlement to the right to deduct input tax in the total sum of £462,854 in respect of 115 purchases of soft drinks in the periods 03/11 and 06/11. The ground for that decision was that the input tax incurred by UMR arose from transactions connected with the fraudulent evasion of VAT, namely so-called Missing Trader Intra-Community or MTIC fraud, and that UMR knew or should have known of that fact. The Tribunal's decision was given after a five day hearing at which a number of witnesses gave evidence, including UMR's director Henry Donaldson.

2. It should be noted at the outset that this is an unusual case because, although HMRC's case was that all the transactions in issue were connected with MTIC fraud, the Tribunal concluded that the majority of the transactions were connected with a different form of fraudulent evasion of VAT. It is this factor which lies at the heart of UMR's first three grounds of appeal.

Background

3. UMR was incorporated in 1982. As its name implies, UMR is based in Northern Ireland. It has traded in non-ferrous scrap metals since its incorporation. In about 2000 Mr Donaldson started wholesale trading in soft drinks. From about 2006 this business was carried on through UMR. It was common ground before the Tribunal that, during the relevant periods, UMR engaged in soft drinks transactions where there was no connection with fraudulent evasion of VAT.

4. Of the 115 transactions in issue, 103 involved purchases from Irwin Transactions Ltd ("Irwin"), eight purchases from PCB Logistics Ltd ("PCB") and four purchases from Paul Magee. Irwin, PCB and Mr Magee were all based in Northern Ireland. Irwin was controlled by Fearghal Keenan, and it appears to have had a substantial trade in soft drinks. Paul Boyle of PCB was employed full time as a dog warden and Mr Magee was employed full time as a care worker. Both traded in soft drinks on a small scale on the side.

5. UMR's customer for about three-quarters of the goods was Paradox Distribution Ltd ("Paradox"), but smaller quantities were sold to Swift Valley Trading Ltd ("Swift") and Leonsbeg Sales Ltd ("Leonsbeg") and a very small quantity to Texpor Enterprises Ltd. Paradox, Swift and Leonsbeg were all based in the Republic of Ireland ("the Republic").

6. It was common ground before the Tribunal that the supplier to PCB and Mr Magee was Mark Cartel trading as M J Cartel, that Mr Cartel (or someone

who had fraudulently adopted that name) had failed to account for VAT on those sales and that HMRC had been unable to contact him. Thus Mr Cartel was a missing trader. Accordingly, there was no dispute that UMR's purchases from PCB and Mr Magee were connected with the fraudulent evasion of VAT. The only issues were whether UMR knew, or should have known, that that was the case.

7. There was a dispute between the parties, however, as to who had supplied Irwin. HMRC's case was that the suppliers were Landmark Wholesale Ltd ("Landmark"), Linkup Solutions Ltd ("Linkup") and Eurolink Trading Ltd ("Eurolink"). All three of these were legitimate UK VAT registered businesses, but their VAT numbers had been "hijacked" by fraudsters. It was common ground that they had not accounted for VAT on any such sales. Thus, on HMRC's case, the fraudsters who had hijacked the VAT numbers were missing traders, and hence UMR's purchases from Irwin were connected with fraudulent evasion of VAT. For convenience, we will refer to the fraudsters as "Landmark *et al*" even though the legitimate businesses were not involved. UMR's case was that the suppliers were William Kirk trading as Oriel Soft Drinks ("Oriel") and Swan Fruit Ltd trading as Swan Wholesale ("Swan"). Oriel and Swan were legitimate traders, both of which were based in the Republic. Purchases by Irwin from Oriel and Swan would therefore have been effectively zero-rated (since the reverse charge on import balanced the input tax credit on onward supply). Moreover, Oriel and Swan had purchased the goods from the manufacturers Coca Cola (in the case of drinks such as Coke, Diet Coke and Fanta) and GlaxoSmithKline (in the case of Lucozade), who were based in Northern Ireland. Accordingly, there was an issue as to whether UMR's purchases from Irwin were connected with fraudulent evasion of VAT. There were also issues as to whether UMR knew, or should have known, that that was the case.

8. It emerged during the hearing before the Tribunal that there were documents which, on their face, appeared to show that Irwin was purchasing lorry loads of various soft drinks from Landmark *et al*, and then a few days later purchasing identical loads from Oriel, before selling both loads back-to-back to either UMR or Euromark, a business registered for VAT in the Republic. For example, deal 21 involved 720 Coke 500ml, 288 Diet Coke 500ml, 288 Fanta Orange 500ml, 288 Sprite 500ml and 144 Fanta Lemon 500ml. One set of documents shows these goods being sold by Landmark to Irwin on 24 February 2011. Another set of documents shows them being sold by Oriel to Irwin on 28 February 2011. Likewise, there are documents evidencing sales by Irwin to UMR on 28 February 2011 and by Irwin to Euromark on 2 March 2011. Again, sales to Euromark would have been zero-rated.

9. Irwin's VAT returns from February 2008 to September 2011 showed outputs of some £65 million and inputs of some £62 million. The output tax roughly balanced the input tax claimed on a quarterly basis, and in the same period of 3½ years the total VAT accounted for was only £39,302.

The law

10. In Joined Cases C439/04 and C440/04 *Kittel v Etat Belge* [2006] ECR I-616 the Court of Justice of the European Communities (Third Chamber) held as follows:

> "54. As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep* [2004] ECR I-5337, paragraph 76). Community Law cannot be relied on for abusive or fraudulent ends (see, inter alia, Case C-367/96 *Kefalas and Others* [1998] ECR I-2843, paragraph 20; Case C-373/97 *Diamantis* [2000] ECR I-1705, paragraph 33; and Case C-32/03 *Fini H* [2005] ECR I-1599, paragraph 32).
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> 55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 *Rompelman* [1985] ECR 655, paragraph 24; Case C-110/94 *INZO* [1996] ECR I-857, paragraph 24; and *Gabalfrisa*, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see *Fini H*, paragraph 34).
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> 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.
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> 57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
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> 58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions is apt to prevent them.
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> 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'.
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> 60. It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller,

> Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void – by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller – causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.
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> 61. By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."

11. In *Mobilx Ltd v Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517, [2010] STC 1436 the Court of Appeal had to consider the proper interpretation and application of the ECJ's decision in *Kittel*. Moses LJ, with whom Carnwath LJ (as he then was) and Sir John Chadwick agreed, considered the meaning of the words "should have known" and held as follows:

> "51. Once it is appreciated how closely *Kittel* follows the approach the court had taken six months before in *Optigen*, it is not difficult to understand what is meant when it is said that a taxable person 'knew or should have known' that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT. In *Optigen* the Court ruled that despite the fact that another prior or subsequent transaction was vitiated by VAT fraud in the chain of supply, of which the impugned transaction formed part, the objective criteria, which determined the scope of VAT and of the right to deduct, were met. But they limited that principle to circumstances where the taxable person had 'no knowledge and no means of knowledge' (§ 55). The Court must have intended *Kittel* to be a development of the principle in *Optigen*. *Kittel* is the obverse of *Optigen*. The Court must have intended the phrase 'knew or should have known' which it employs in §§59 and 61 in *Kittel* to have the same meaning as the phrase 'knowing or having any means of knowing' which it used in *Optigen* (§55).
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> 52. If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in *Kittel*. A trader who fails to deploy means of

knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

12. Moses LJ considered the extent of knowledge that was required at [53]-[60]. He held at [55] that it was not sufficient for HMRC to show that the trader should have known that he was running a risk that his purchase was connected with fraud. He concluded:

> "59. The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel.*
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> 60. The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

13. Moses LJ held at [61]-[62] that this approach did not infringe the principle of legal certainty. As he said in [61]:

> "…It is difficult to see how an argument to the contrary can be mounted in the light of the decision of the court in *Kittel*. The route it adopted was designed to avoid any such infringement. A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into that transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."

14. Moses LJ considered the facts of the appeals before the Court of Appeal at [67]-[80]. In relation to the appeal by Blue Sphere Global Ltd he held at [75]:

> "The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT."

15. Moses LJ considered questions of proof at [80]-[85]. He held at [81] that the burden lay upon HMRC to prove the trader's state of knowledge. He went on at [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. The danger in focussing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in *Kittel*, namely, whether a 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."

16. At paragraph [84] he said:

> "Such circumstantial evidence … will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reach a large and predictable reward over a short space of time."

17. In *Fonecomp Ltd v Commissioners for Her Majesty's Revenue and Customs* [2015] EWCA Civ 39, [2015] STC 2254 the Court of Appeal gave further consideration to this question. Arden LJ, with whom McFarlane and Burnett LJJ agreed, said:

> "47. Mr Lasok also relies on the fact that the FTT held that Fonecomp did not know exactly how the fraud was perpetrated. …
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> 48. As the UT rightly held, these negative findings did not matter in the light of the other findings of the FTT …. Lack of knowledge of the specific mechanics of a VAT fraud affords no basis for any argument that the decision of either tribunal was wrong in law: what is required is simply participation with knowledge in a transaction 'connected with fraudulent evasion of VAT' (*Kittel,* [61] …).
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> 49. The fraud may involve a complex web of transactions. As Briggs J held in *Megtian Ltd v Revenue and Customs Comrs* [2010] STC 840 at [37]:

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

50. Mr Lasok further relies on the holding of Moses LJ in *Mobilx* that the words ‘should have known’ (referring to the deemed knowledge of the trader) meant ‘has any means of knowing’: per Moses LJ at [51]. Mr Lasok further argues that Fonecomp could not have found out about the fraud even if it made inquiries because the fraud did not relate to the chain of transactions with which it was concerned.

51. However, in my judgment, the holding of Moses LJ does not mean that the trader has to have the means of knowing how the fraud that actually took place occurred. He has simply to know, or have the means of knowing, that fraud has occurred, or will occur, at some point in some transaction to which his transaction is connected. The participant does not need to know how the fraud was carried out in order to have this knowledge. This is apparent from [56] and [61] of *Kittel* cited above. Paragraph 61 of *Kittel* formulates the requirement of knowledge as knowledge on the part of the trader that ‘by his purchase he was participating in a transaction connected with fraudulent evasion of VAT’. It follows that the trader does not need to know the specific details of the fraud.”

The Tribunal’s decision

18. The Tribunal’s decision is a careful and detailed one running to 210 numbered paragraphs. It is structured as follows: paragraphs [1]-[5] consist of an introduction in which the Tribunal identifies the issues to be decided and describes the evidence before it; paragraphs [6]-[28] set out the Tribunal’s findings of background fact; paragraphs [29]-[59] set out the Tribunal’s analysis of the law; paragraphs [60]-[101] set out the Tribunal’s findings of fact concerning the general circumstances surrounding the transactions in issue; paragraphs [102]-[138] set out the Tribunal’s findings of fact concerning the deal chains in issue; paragraphs [139]-[147] set out the Tribunal’s findings of fact on the issue of whether the Irwin transactions were connected with fraud; paragraphs [148]-[184] set out the Tribunal’s findings of fact concerning the issues of knowledge and means of knowledge; paragraphs [185]-[202] set out the Tribunal’s reasoning and conclusion on the issue of whether UMR had actual knowledge that the purchases were connected with the fraudulent evasion of VAT; paragraphs [203]-[207] set out the Tribunal’s reasoning and conclusion on the issue of whether UMR should have known that the purchases were connected with the fraudulent evasion of

VAT; and paragraphs [208]-[210] set out the Tribunal's disposal of the appeal.

19. It is convenient to note the following points about the Tribunal's decision before proceeding further. First, UMR does not suggest that the Tribunal misdirected itself in law.

20. Secondly, the Tribunal found at [117]-[123] and [144]-[146] that the deals purportedly involving sales from Landmark *et al* to Irwin to Euromark did not actually take place, but rather were simply a paper trail dishonestly created by Irwin, and that the actual deals involved sales from Oriel and Swan to Irwin to UMR. The Tribunal further found that Irwin never intended to account to HMRC for output tax on its supplies to UMR, and that the probable purpose of the paper trail was to offset the input tax credit from the apparent purchases from Landmark *et al* against the output tax.

21. Thirdly, the Tribunal found at [137] that the goods could only be traced back to Coca Cola in 10 deals.

22. Fourthly, the Tribunal concluded at [136], [163] and [180] that Mr Donaldson was not a truthful witness, and it did not accept various aspects of his evidence. The Tribunal also noted at [133] and [196] that UMR had not called one Gary Chambers, who had worked as a delivery driver for Irwin and then for UMR, as a witness for reasons that the Tribunal found unconvincing.

The nature of an appeal from the First-tier Tribunal to the Upper Tribunal

23. Section 11(1) of the Tribunals, Courts and Enforcement Act 2007 provides for a right of appeal from the First-tier Tribunal to the Upper Tribunal "on any point of law arising from a decision made by the first tier tribunal other than an excluded decision". It is well established that the principles established under section 11(1) of the Tribunals and Inquiries Act 1992 and its predecessors were equally applicable under section 11(1) of the 2007 Act.

24. In *Edwards v Bairstow* [1956] AC 14 Viscount Simonds said at 29:

> "… though it is a pure finding of fact, it may be set aside on grounds which have been stated in various ways but are, I think, fairly summarised by saying that the court should take that course if it appears that the commissioners have acted without any evidence or upon a view of the facts which could not reasonably be entertained."

Lord Radcliffe said at 36:

> "If the case contains anything ex facie which is bad law and which bears upon the determination, it is obviously, erroneous in point of law. But, without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the

relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene."

25. In *Georgiou v Customs and Excise Commissioners* [1996] STC 463 Evans LJ, with whom Saville and Morritt LJJ (as they then were) agreed, said at 476:

> "There is a well-recognised need for caution in permitting challenges to findings of fact on the ground that they raise this kind of question of law. … It is all too easy for a so-called question of law to become no more than a disguised attack on findings of fact which must be accepted by the courts. As this case demonstrates, it is all too easy for the appeals procedure to the High Court to be abused in this way. Secondly, the nature of the factual inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact. The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but was there evidence before the tribunal which was sufficient to support the finding which it made? In other words, was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled.
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> It follows, in my judgment, that for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make. What is not permitted, in my view, is a roving selection of the evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong."

26. In *Procter & Gamble UK v Revenue and Customs Commissioners* [2009] EWCA Civ 407, [2009] STC 1990 Jacob LJ, with whom Mummery LJ and Toulson LJ (as he then was) agreed, said:

> "7. … in the end counsel were agreed that what really mattered was whether the decision of the Tribunal was wrong in law. For it is the Tribunal which is the primary fact finder. It is also the primary maker of a value judgment based on those primary facts. Unless it has made a legal error in that in so doing (e.g. reached a perverse finding or failed to make a relevant finding) or has misconstrued the statutory test it is not for an appeal court to interfere.
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> …

> 11. It is also important to bear in mind that this case is concerned with an appeal from a specialist Tribunal. Particular deference is to be given to such Tribunals for Parliament has entrusted them, with all their specialist experience, to be the primary decision maker, see per Baroness Hale in *AH (Sudan) v Secretary of State for the Home Department* [2007] UKHL 49, [2008] 1 AC 678 at [30] …."

27. What Baroness Hale said in *AH (Sudan)*, which has since been approved by Sir John Dyson SCJ (as he then was) giving the judgment of the Supreme Court in *MA (Somalia) v Secretary of State for the Home Department* [2007] UKSC 49, [2011] 2 All ER 65 at [43], was this:

> " … This is an expert tribunal charged with administering a complex area of law in challenging circumstances. To paraphrase a view I have expressed about such expert tribunals in another context, the ordinary courts should approach appeals from them with an appropriate degree of caution; it is probable that in understanding and applying the law in their specialised field the tribunal will have got it right: see *Cooke v Secretary of State for Social Security* [2002] 3 All ER 279, para 16. They and they alone are the judges of the facts. It is not enough that their decision on those facts may seem harsh to people who have not heard and read the evidence and arguments which they have heard and read. Their decisions should be respected unless it is quite clear that they have misdirected themselves in law. Appellate courts should not rush to find such misdirections simply because they might have reached a different conclusion on the facts or expressed themselves differently. … "

<u>The appeal</u>

28. UMR appeals on six grounds:

(1) The Tribunal wrongly made findings on matters that were not in issue between the parties, which said issues had not been pleaded, in respect of which no evidence directed to them had been led and no argument advanced.

(2) The Tribunal wrongly connected the transactions in which UMR was involved with an attempt fraudulently to evade VAT on the part of Irwin notwithstanding that no such connection had been alleged by HMRC, no evidence had been led with a view to establishing such a connection and such connection had been expressly disavowed by HMRC in their closing submissions.

(3) The Tribunal wrongly translated an unspecified fraud on the part of Irwin into an attempt fraudulently to evade its own VAT liability. The

Tribunal ought not to have made any finding with regard to any separate and distinct fraud by Irwin.

(4) The Tribunal was not entitled to draw an inference of knowledge of the Irwin fraud from the primary facts it had found proved and further failed to take into account certain other additional relevant factors when drawing the inference it did.

(5) With regard to its finding that UMR knew that the purchases from PCB and Mr Magee were connected with fraud, the Tribunal wrongly found that UMR knew or ought to have known of the connection to Mr Cartel and in drawing such an inference focused overmuch on due diligence.

(6) With regard to its finding that the UMR should have known that the transactions were connected to fraud, the Tribunal applied the wrong test and focused overmuch on due diligence instead of on the circumstances.

Grounds (1)-(3): Were the purchases from Irwin connected with fraudulent evasion of VAT?

29. These three grounds all traverse the same issue. In essence, UMR makes two complaints. The first complaint is that the Tribunal's finding that Irwin fraudulently defaulted on the payment of output tax in respect of the sales to UMR, rather than Landmark *et al*, was procedurally unfair: no such case had been pleaded by HMRC, nor had HMRC led any evidence to support such a case or advanced such a case in argument, and accordingly UMR had not led any evidence to meet that case. Thus UMR was taken by surprise. For good measure, UMR says that HMRC disavowed any such case in closing submissions. The second complaint is that the Tribunal's finding was not open to it on the evidence.

30. As is usually the case with complaints of procedural unfairness, the first complaint requires us to reconstruct the procedural context in which the Tribunal made its finding. We shall do so as briefly as we can. The starting point is that, in its Notice of Appeal to the Tribunal, UMR disputed that it knew, or should have known, that its purchases were connected with fraud. It did not dispute that the purchases were in fact connected with fraud. We were informed by counsel for HMRC that it was only when UMR served the second witness statement of Mr Donaldson on 8 September 2014, about eight weeks before the hearing, that it became clear to HMRC that UMR was disputing that the purchases from Irwin were connected with fraud. HMRC raised no objection to this change in UMR's stance. Thus the case was not one which proceeded to a hearing strictly in accordance with the parties' initial statements.

31. More importantly, we were informed by counsel for HMRC that it was only during the course of the hearing that HMRC's counsel appreciated that there were matching invoices for the Landmark *et al*/Irwin and Oriel or Swan/Irwin

purchases and the Irwin/UMR and Irwin/Euromark sales, something which UMR appeared to have already realised. Furthermore, as the Tribunal recorded in its decision at [117], [123] and [145], it was UMR's own submission to the Tribunal that the Landmark *et al*/Irwin and Irwin/Euromark transactions had not taken place, but were simply a paper trail dishonestly created by Irwin.

32. If the Landmark *et al*/Irwin and Irwin/Euromark transactions did not take place, but were simply a paper trail dishonestly created by Irwin, as UMR itself submitted, an obvious question which arose was the purpose of the paper trail. An equally obvious answer, given Irwin's remarkably low VAT payments, was that Irwin was offsetting the input tax credit on the fictitious purchases from Landmark *et al* against its output tax on deals with UMR, and hence concealing a default on its own output tax liability. Not only was this an obvious answer, but Judge Cannan expressly put this to counsel for UMR during the course of his closing submissions at pages 65-67 of the transcript for day five of the hearing. Counsel's response to Judge Cannan's questions was that it was dangerous to speculate as to Irwin's reasons for creating the paper trail. He did not submit that it was not open to HMRC to advance such a case or to the Tribunal to find that such was the case. Nor did he protest that UMR was being taken by surprise or that UMR would be disadvantaged because it had not come prepared to meet such a case.

33. Accordingly, while it is correct that this was not a case which HMRC had pleaded, led evidence to support or advanced in argument, it was a case which flowed logically from UMR's own case and it was a case which counsel for UMR was given the opportunity make submissions in respect of during the course of argument. If counsel for UMR considered that UMR was being taken by surprise, he should have said so there and then. In that way the Tribunal could have considered whether the complaint was justified, and if so how to deal with it. For example, the Tribunal could have considered whether to give UMR an adjournment and/or to permit UMR to adduce further evidence. Since no complaint was made, the Tribunal did not have occasion to consider these options. In those circumstances, it is too late for UMR to raise the complaint for the first time on appeal.

34. As for the contention that HMRC expressly disavowed such a case in closing submissions, we do not accept this. It is true that, as the Tribunal recorded in its decision at [146], counsel for HMRC accepted that, if goods were supplied by Coca Cola to Oriel, by Oriel to Irwin and by Irwin to UMR, then that was the end of HMRC's case that UMR's purchases were connected to fraud. But counsel for HMRC did not disavow the fraud which the Tribunal found. Furthermore, as noted above, the Tribunal found that only 10 deals could be traced back to Coca Cola.

35. Turning to UMR's second complaint, counsel for UMR made three main points. First, he pointed out that there had been no investigation by either party into Irwin's VAT affairs. Indeed, HMRC had started an enquiry in November 2011, but this was never completed because Irwin ceased trading and de-registered for VAT in December 2011. We are unimpressed by this. The Tribunal had the evidence as to the matching invoices and as to Irwin's

very low VAT returns. It also had evidence that Irwin was controlled by Mr Keenan even though he was not a director and that Mr Keenan had told HMRC that he had paid Landmark *et al* in cash on delivery, which the Tribunal understandably considered was not credible (see [78] and [115]). It also noted that there was no evidence that there were any purchase orders, transport documents, goods receipts or payments from Irwin to Landmark *et al* (see [116]).

36. Secondly, counsel for UMR submitted that HMRC's witness Heather Arnold (no relation) had given an alternative explanation for Irwin's low VAT returns, namely that Irwin had purchased goods from the Republic zero-rated and sold goods back to the Republic zero-rated, and that the Tribunal did not appear to have considered that explanation. But this evidence was given in answer to questions from Judge Cannan, who pointed out to her that, if Irwin was making a profit on its deals (in particular its sales to UMR), then one would expect it to be accounting for VAT in larger sums than it had. Given that Irwin's outputs broadly matched its inputs, there had to be an input to match the (large) net output liability on the Oriel-Irwin-UMR sales. Mrs Arnold's explanation of matching imports and exports did not provide such a net input credit. It is implicit in the Tribunal's decision that it did not accept Mrs Arnold's explanation, and we consider that the Tribunal was entitled not to do so.

37. Thirdly, counsel for UMR pointed out that Mrs Arnold had accepted that in some cases there were two or three duplicate invoices and that the Tribunal had heard evidence about Irwin having large sums in cash. He submitted that an alternative explanation for the paper trail, which the Tribunal had failed to consider, was that Irwin was engaged in money laundering. Leaving aside the fact that the Tribunal did not accept that Irwin had paid for deliveries in cash, this suggestion was first advanced in counsel's oral submissions, not having been made by UMR's application for permission to appeal or skeleton argument. Accordingly, it is plainly an afterthought. Moreover, in those circumstances it is not surprising that the Tribunal did not consider it. In any event, we do not consider that this is a likely explanation for Irwin having created matching sets of invoices in the way that it did.

38. In our judgment the conclusion which the Tribunal reached was one that was properly open to it on the evidence before it.

Ground (5): Did UMR know that the purchases from PCB and Mr Magee were connected with fraudulent evasion of VAT?

39. It is convenient to deal with ground (5) next before turning to ground (4). As counsel for HMRC submitted, in considering the Tribunal's findings as to knowledge, it is of central importance that the Tribunal did not believe Mr Donaldson's evidence. The Tribunal had the advantage of seeing Mr Donaldson give evidence, which we have not had. Moreover, it gave a series of reasons for not believing Mr Donaldson's evidence. Still further, although counsel for UMR submitted that it was not open to the Tribunal to find that UMR knew that the purchases were connected with fraudulent evasion of

VAT, he did not go so far as to submit that it was not open to the Tribunal to disbelieve Mr Donaldson's evidence. Given that, as the Tribunal recorded at [149], it is Mr Donaldson's knowledge that matters, it inevitably follows that UMR faces a difficult task in seeking to undermine the Tribunal's conclusions as to knowledge.

40. So far as knowledge that UMR's purchases from PCB and Mr Magee were connected with fraudulent evasion of VAT is concerned, the Tribunal relied on a number of pieces of evidence in reaching its conclusion, and in particular the following points. First, Mr Donaldson was aware of the risk of VAT fraud, having been warned about it by Mrs Arnold in October 2010 (see [151] and [198]). Secondly, Mr Donaldson knew that both Mr Boyle and Mr Magee were new to the trade and had full-time jobs, yet were able to source goods more cheaply than UMR (see [99]-[100] and [197]). Thirdly, Mr Donaldson failed to carry out proper checks on PCB and Mr Magee, but gave what the Tribunal found to be an exaggerated and misleading account of the due diligence he had carried out (see [159]-[163] and [197]). Fourthly, Mr Donaldson claimed for the first time in his oral evidence that he had visited Mr Boyle and Mr Magee a number of times trying to question them about the tax losses. The Tribunal did not believe that account, and it concluded that the reason why Mr Donaldson had given false evidence on this point was that he had realised that the reaction of an honest trader would be to seek a full explanation and recompense from his suppliers (see [178]-[180] and [200(3)]).

41. Counsel for UMR submitted that the Tribunal had focused unduly on the question of due diligence, contrary to the guidance of Moses LJ in *Mobilx*. We do not accept this. While the Tribunal did consider the checks which Mr Donaldson had carried out, the unsatisfactory nature of those checks was just one of the factors it considered. Indeed, it placed more weight on the false evidence Mr Donaldson had given about the checks than it did upon the checks themselves.

42. Counsel for UMR also argued that the Tribunal's conclusion in relation to PCB and Mr Magee was tainted by its conclusion in relation to Irwin. We do not accept this either. The Tribunal's decision demonstrates very clearly that it was well aware that the cases with respect to Irwin on the one hand and with respect to PCB and Mr Magee on the other hand were different. Moreover, it gave them separate consideration and relied upon different reasons for reaching its conclusions. If anything, in our view, the position is the other way round: as discussed below, the Tribunal's conclusion in relation to PCB and Mr Magee lends support to its conclusion in relation to Irwin.

43. In our judgment the conclusion which the Tribunal reached was one that was properly open to it on the evidence before it.

Ground (4): Did UMR know that the purchases from Irwin were connected with fraudulent evasion of VAT?

44. Turning to the question of whether UMR knew that the purchases from Irwin were connected with fraudulent evasion of VAT, again the starting point is that the Tribunal disbelieved Mr Donaldson's evidence. Furthermore, as

counsel for HMRC submitted, once it is found, as we have concluded that the Tribunal was entitled to find, that Mr Donaldson knew that UMR's purchases from PCB and Mr Magee were connected with fraudulent evasion of VAT, that casts further doubt upon Mr Donaldson's claim that he was innocently caught up in any fraud which might have been perpetrated by Irwin.

45. Again, the Tribunal relied on a number of pieces of evidence in reaching its conclusion, and in particular the following points. First, Mr Donaldson's knowledge of the risk of VAT fraud. Secondly, the Tribunal found that Mr Donaldson was aware that there was a close connection between Irwin, Swift and Leonsbeg and that Irwin was giving up the profits available on a direct sale to Swift or Leonsbeg without any good reason (see [181] and [193]). In the case of Paradox there was not the same close connection, but nevertheless Irwin knew that UMR's main customer was Paradox (see [182] and [194]). Thirdly, Mr Donaldson made no serious attempt to obtain an explanation or recompense from Irwin or even to point the finger at Irwin (see [129], [176]-[177]. [180] and [195]). Fourthly, UMR had failed to call Mr Chambers, who the Tribunal concluded was aware of Irwin's fraud (see [133], [196] and [200(2)]). Fifthly, the Tribunal did not accept Mr Donaldson's evidence with respect to goods being sourced by Oriel and Swan from Coca Cola. In this regard, the Tribunal regarded it as significant both that Mr Donaldson had not mentioned this prior to his second witness statement and that Mr Donaldson had embellished his account in oral evidence by claiming that he (and Mr Chambers) had seen pallets of Coca Cola with the name Oriel written on them and by claiming that UMR's customers wanted "Irish" coke rather than "English" coke (see [127]-[132] and [200(1)]).

46. Counsel for UMR advanced six main submissions attacking the Tribunal's conclusion. First, he submitted that, even if the Tribunal was correct as to Irwin's output tax fraud, the very fact that this was a different fraud to that alleged by HMRC showed that UMR could not have known this. We do not accept this submission. The Tribunal did not find that UMR was aware of the precise nature of the fraud, nor did it need to. As is clear from the decision of the Court of Appeal in *Fonecomp*, it is not necessary for HMRC to prove that the taxpayer knew the precise details of the fraud. Rather, it is sufficient for HMRC to prove that the taxpayer knew (or had the means of knowing) that the purchases were connected in some way with the fraudulent evasion of VAT.

47. Secondly, counsel for UMR submitted that the Tribunal had wrongly relied upon evidence adduced by HMRC of knowledge of fraudulent evasion of VAT by Landmark *et al* as knowledge of a different fraud. We do not accept this. The question the Tribunal asked itself, having found that the purchases from Irwin were in fact connected with the fraudulent evasion of VAT, was whether Mr Donaldson knew this. In answering that question, the Tribunal relied upon a number of different strands of evidence, each of which had been investigated during the hearing.

48. Thirdly, counsel for UMR submitted that the Tribunal was wrong to rely upon the fact that Irwin could have sold directly to Paradox, Swift and Leonsbeg. He submitted that the Tribunal had failed to take into the fact that it was the

purchaser's choice as to whom to order from, that Mr Donaldson had explained that UMR was able to offer a wider range of drinks and that Irwin could have been receiving an "overrider" or volume rebate (as the Tribunal had accepted had occurred in the case of a supply through Henderson Food Service Ltd). We are not persuaded by these points. Even if Irwin had received an overrider, it could still have made a greater profit by selling direct. What would have happened if Irwin had approached Paradox, Swift and Leonbeg? So far as the wider range is concerned, it was UMR's own case that most of the goods were manufactured by Coca Cola and the Tribunal found at [153] that it was only on a small number of occasions that UMR made sales made of purchases from more than one supplier. In any event, we consider that it was open to the Tribunal to conclude that the purchasers would, if offered a better price for specific goods, have accepted that offer and taken a smaller load from UMR. That being so, we consider that the Tribunal was entitled to conclude that Irwin had not approached Paradox, Swift and Leonbeg. That invites the question: why not?.

49. Fourthly, counsel for UMR criticised the Tribunal's reliance upon Mr Donaldson's failure to seek an explanation or recompense from Irwin. He submitted that this was muddled reasoning, because if Mr Donaldson knew that Irwin was committing fraud, there would have been no point in him pursuing Irwin. But if he didn't know Irwin was committing fraud, he had no remedy against Irwin and there would be no point in pursuing Irwin. He nevertheless might have been expected to seek an explanation and/or help in fighting HMRC's claim.

50. Fifthly, counsel for UMR criticised the Tribunal's reliance upon UMR's failure to call Mr Chambers. He submitted that this amounted to reversing the burden of proof. He also argued that there was no evidence that Mr Chambers knew about the false invoice trail. We are not persuaded by these points. The Tribunal stated clearly that the burden of proof was on HMRC. It was entitled to regard UMR's failure to call Mr Chambers as significant without reversing the burden of proof. As for Mr Chambers' knowledge of the fraud, the Tribunal inferred that he did for the reasons it explained (see [133]-[134] and [196]). We consider that it was entitled to do so.

51. Finally, counsel for UMR criticised the Tribunal's finding that Mr Donaldson's evidence lacked credibility because of what he had said about a related company called M1 (see [165]-[169] and [199]-[200]). But the Tribunal was clear that this point related to Mr Donaldson's general credibility rather than specifically his knowledge of the fraud.

52. Overall, in our judgment the conclusion which the Tribunal reached was one that was properly open to it on the evidence before it.

Ground (6): Should UMR have known that the purchases from Irwin, PCB and Mr Magee were connected with fraudulent evasion of VAT?

53. In the light of our conclusions on grounds (1)-(5), ground (6) is academic. We shall nevertheless deal with it with briefly. We shall do so upon the assumption, contrary to the conclusions we have reached above, that the

Tribunal was not entitled to find that Mr Donaldson knew that UMR's purchases were connected with the fraudulent evasion of VAT. The question then is whether the Tribunal was entitled to find that he should have known this.

54. Counsel for UMR submitted that it was not open to the Tribunal to find that that Mr Donaldson should have known. He emphasised that the test was that this was the only reasonable explanation for the nature and circumstances of the transactions. He pointed out that the Tribunal had relied upon essentially the same matters in concluding that Mr Donaldson should have known that the transactions were connected with fraud as in concluding that he did know. He also pointed out that the Tribunal had absolved Paradox, Swift and Leonsbeg of complicity in the fraud, and said that there was no reason why UMR should have known any more than those traders. Finally, he submitted that UMR had carried out proper due diligence on PCB and Mr Magee.

55. We do not accept these submissions. Even if the evidence did not entitle the Tribunal to find that Mr Donaldson actually knew that the transactions were connected with fraud, we consider that there was ample material to justify the Tribunal's conclusion that he should have known. We do not accept that there was no reason why UMR should have known any more than Paradox, Swift and Leonsbeg. UMR purchased the goods in question from Irwin, whereas they did not. Moreover, it was UMR's case that it knew where Irwin was sourcing the goods from. As for due diligence, as discussed above, the Tribunal did not accept that UMR had carried out proper due diligence in relation to PCR and Mr Magee.

Conclusion

56. For the reasons given above, the appeal is dismissed.

MR JUSTICE ARNOLD

JUDGE CHARLES HELLIER

Release date: 20 July 2016