Neutral citation number
[2010] UKUT 259 (TCC)

Appeal number
FTC/24/2009

Value Added Tax – input tax – disallowance of input tax – MTIC fraud – whether fraudulent evasion of VAT – whether Appellant knew or should have known that its purchases were connected with fraud

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

EURO STOCK SHOP LIMITED **Appellant**

- and –

THE COMMISSIONERS OF HER MAJESTY'S REVENUE AND CUSTOMS **Respondent**

Tribunal: The Hon Mr Justice Arnold

Sitting in public in London on 5 and 6 July 2010

Nicola Preston counsel, instructed by Keystone Law, for the Appellant

Christopher Foulkes counsel, instructed by Howes Percival, for the Respondent

[2010] UKUT 259 (TCC)

MR JUSTICE ARNOLD:

Introduction

1. This is an appeal from the First-Tier Tribunal (Tax) (Tribunal Judge Dr K. Khan and Mr P. D. Davda FCA) dated 23 July 2009. By its decision the First-Tier Tribunal, which hereinafter I will refer to for brevity simply as "the Tribunal", dismissed the appeal of Euro Stock Shop Ltd ("ESS") against three decisions of the Commissioners of Her Majesty's Revenue and Customs ("HMRC") to deny entitlement to the right to deduct input tax in the total sum of £1,710,930.39 in respect of purchases of Intel P4 CPUs in the periods 04/06 and 05/06. The ground for those decisions was that the input tax incurred by ESS arose from transactions connected with the fraudulent evasion of VAT and that ESS knew or should have known of that fact. The Tribunal's decision was given after a seven day hearing at which a number of witnesses gave evidence, including Bharat Shaunak, a director of ESS.

The Tribunal's decision

2. The Tribunal's decision is a lengthy and detailed one running to 116 numbered paragraphs and 39 single-spaced pages. It is structured as follows: in paragraphs 1-3 there is an introduction; in paragraphs 3-6 there is an explanation of missing trader intra-Community ("MTIC") fraud; in paragraphs 7-14 the Tribunal identifies the relevant legislation and case law; in paragraph 15 the Tribunal summarises ESS's arguments; at paragraph 16 the Tribunal summarises HMRC's arguments; in paragraphs 17-29 the Tribunal summarises the applicable law; in paragraphs 31-39 the Tribunal summarises the history of ESS; in paragraph 40 the Tribunal summarises the transactions in question; in paragraph 41 the Tribunal poses the questions that need to be answered in order for HMRC's case to succeed; in the remainder of paragraph 41 through to paragraph 73 the Tribunal considers the first of those questions, namely whether ESS's transactions were connected to a VAT loss; in paragraphs 74-84 the Tribunal considers the second question, namely whether the tax loss was attributable to fraud; and in paragraphs 85-115 the Tribunal considers the third question, namely whether ESS knew that the transactions were connected to fraud. The Tribunal's answer to each of those questions was in the affirmative. So far as the third question is concerned, the Tribunal found in paragraph 108 that ESS had actual knowledge of the fraud, a finding which was repeated and elaborated in paragraphs 114 and 115.

The law

3. 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).

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).

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'.

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.

> 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."

4. In *Mobilx Ltd v Commissioners for Her Majesty's Revenue and Customs* [2010] EWCA Civ 517, a decision given after the decision of the Tribunal in the instant case, 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 and Sir John Chadwick agreed, considered the meaning of the words "should have known". He held:

> "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).
>
> 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."

5. 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.*
>
> 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."

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

7. 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."

8. 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."

9. 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."

The nature of an appeal from the First-Tier Tribunal to this Tribunal

10. The nature of an appeal in a case such as the present was described in *Mobilx Ltd v Commissioners for Her Majesty's Revenue and Customs* [2009] EWHC 133 (Ch) by Floyd J as follows:

> "13. Section 11(1) of the Tribunals and Inquiries Act 1992 provides that an appeal lies to the High Court if a party '… is dissatisfied in point of law' with a decision of the VAT and Duties Tribunal.
>
> 14. In *Georgiou v Customs and Excise Commissioners* [1996] STC 463 CA at 476, Evans LJ refers to excerpts from the speeches of Viscount Simonds and Lord Radcliffe in *Edwards v Bairstow* [1956] AC 14, 14-15) and observes (at 476F-G) that:
>
> > '…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 <u>was there evidence before the tribunal which was sufficient to support the finding which it made?</u> 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.'

15. At page 476H Evans LJ set out a four stage process for examining challenged to findings of fact:

> '… 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.'

16. Complete absence of evidence, or the evidence being to the contrary effect, are two of the grounds on which it may be said that a tribunal was not entitled to reach a conclusion of fact. It is also well established that a tribunal is not entitled to find serious allegations established against a party who calls relevant witnesses unless those allegations are clearly formulated and put in cross examination…

18. Subject to these very tight limitations, it is not open to the High Court to conduct a review of the evidence to see whether it would have reached the same conclusion. An appellate court is poorly placed to assess the value of oral evidence given before the Tribunal. Moreover, if the analysis of the evidence is such that reasonable judicial minds might differ on the outcome, there is no basis for saying that the decision of the tribunal of first instance is wrong."

11. Since that decision, section 11(1) of the Tribunals and Inquiries Act 1992 has been repealed and replaced by section 11(1) of the Tribunals, Courts and Enforcement Act 2007, which provides for a right of appeal 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 was common ground before me that the principles established under section 11(1) of the 1992 Act were equally applicable under section 11(1) of the 2007 Act.

The appeal

12. ESS challenges the decision of the Tribunal on a number of grounds. These grounds fall into two groups. The first group consists of contentions that the Tribunal misdirected itself as to the law. The second group consists of contentions that the Tribunal made findings of fact which it was not entitled to make because there was no evidence to support those findings.

Misdirection as to the law

13. Counsel for ESS submitted that the Tribunal had misdirected itself as to the law in four respects. First, at paragraph 19 the Tribunal said:

> "Underlying [paragraph 61 of *Kittel*] are two points: firstly, a taxable person is entitled to deduct input tax on taxable supplies made which are used for the purposes of their business and secondly, by way of an exceptional derogation from that principle, an entitlement to input tax may be refused to those who are considered by the national court to be involved in a fraud. The exception to the right to deduct is based on knowledge or means of knowledge of fraud and the test of what constitutes fraud is one for the domestic jurisdiction."

14. Counsel for ESS submitted that the reference to the right to deduct tax being refused to those "involved in fraud" was wrong in law. I have trouble understanding this submission, since if anything it puts the test too high, not too low. In any event, as counsel for HMRC submitted, it has to be read in the light of the following sentence which is an unexceptionable statement of the law in the light of the judgment of Moses LJ in *Mobilx*.

15. Secondly, at paragraph 23 the Tribunal said:

> "The failure to take reasonable precautions would not automatically mean that one is participating in a fraud and so forfeits the right to deduct input tax. Where, even if precautions had been taken, it would not have been clear that the transaction had a connection with fraud, then the right to deduct input tax would not be lost in such a circumstance. It is important to establish knowledge of the fraud and to identify the fraud with which the trader's transactions were alleged to be connected and of which he should have known. He should therefore know that there had been a failure to account for VAT by the defaulter or missing trader. He may not know the identity of the missing trader but must know that there was likely to be a missing trader somewhere in the chain. He must also know of a connection between his own transaction and the fraud of the missing trader. It may be difficult to know of the connection directly but, for example, if a trader undertakes a large transaction involving significant profits which is too good to be true he will be taken to have knowledge and will fail the *Kittle* [sic] test of knowledge. "

16. At paragraph 86 the Tribunal said:

> "The Commissioners must prove their assertions of fraud by reference to cogent evidence. Since the allegations are serious, mere assertions are not enough and the evidence must be strong. Where a person simply disregards obvious signs of dishonesty, Nelsonian blindness if you like, then that person cannot say that they were not dishonest. If a person comes by a deal which is too good to be true and ask no questions then they

> may be knowingly participating in a transaction where there is dishonesty. An honest person would not deliberately close their eyes and not ask questions but will seek to learn more about suspicious transaction. Similarly, a person acting recklessly where there are tell tale signs of dishonesty could be taken to be acting with knowledge. As stated earlier, it cannot be concluded that because a company's turnover increased or they failed to conduct certain checks, that they be seen to be involved with fraud. The test is not a negligence based test of failing to do certain things but rather it rests on the Commissioners to show dishonesty or recklessness. In this sense, the Commissioners must show that the Appellant had entered into the transactions knowing they are part of a wider fraud or turned a blind eye to whether or not they were."

17. Counsel for ESS submitted that the Tribunal had misdirected itself in holding that it was sufficient for the Commissioners to prove recklessness. Counsel for HMRC accepted that the reference to recklessness was erroneous. He submitted, however, that the last sentence of paragraph 86 showed that the Tribunal had in fact set what was, if anything, a higher test than necessary. Furthermore, he pointed out that the Tribunal had made a finding of actual knowledge on the part of ESS, and accordingly its findings had satisfied the test as clarified by the Court of Appeal in *Mobilx*.

18. Counsel for ESS also submitted that the Tribunal was wrong to rely on the concept of a transaction that was "too good to be true". Counsel for HMRC submitted that the point made by the Tribunal was a perfectly valid one. In this regard he relied on what was said by Moses LJ in *Mobilx* at [84].

19. In my judgment the Tribunal did not materially misdirect itself as to the law in these paragraphs of the decision for the reasons given by counsel for HMRC.

20. The third respect in which counsel for ESS contended that the Tribunal had misdirected itself was as to the burden of proof. At paragraph 27 the Tribunal said:

> "… The Commissioners have an evidential burden to discharge and to show, on a balance of probabilities, that that fraudulent transaction have taken place. This means in effect that the Commissioners must establish a chain of transactions, the relevant default and the fraudulent purpose of the default. In other words, they must present an answerable case. The burden then shifts to the Appellant to show that they did not have the requisite knowledge or means of knowledge. This shift in proof presumes that it would be the Appellant who has full knowledge of the relevant matters and transactions and should therefore be the person on whom the burden should rest."

21. Counsel for ESS submitted that, in the light of the decision of the Court of Appeal in *Mobilx*, it was clear that the Tribunal was wrong to hold that the burden of proof could shift in this way. Counsel for HMRC pointed out that paragraph 27 of the Tribunal's decision represented the agreed state of the law at the time of the hearing before the Tribunal, but accepted that in the light of the decision in the Court of

Appeal it was not correct. He submitted, however, that this error was of no effect because, when it came to the facts, the Tribunal had found on the balance of probabilities that ESS had had actual knowledge that the transaction was connected to fraud and had not relied upon any shift in the burden of proof to ESS in reaching that conclusion. I accept that submission.

22. Fourthly, the counsel for ESS criticised paragraph 87 of the decision in which the Tribunal said:

> "The Commissioners must raise a sufficient case for the Appellant to answer and the case must be that the Appellant know or ought to have known of the fraud. We know that the fact that a person has not taken every precaution or check does not mean they lose the right to deduct input tax. Faulty due diligence does not mean guilt. The evidence presented to the tribunal must be assessed to establish whether the Appellant had the means of knowing that they were participating in a fraud. It is expected that due diligence would be conducted on one's immediate supplier and, if there is an indication that of impropriety higher up in the chain, a 'dirty' chain, then comprehensive due diligence should also be conducted at that level. The Appellant should therefore act in a reasonable and proportionate manner to establish the bona fide of transactions and if in doubt about the legitimacy of the transactions, the Appellant should cease to trade with those parties."

23. Counsel for ESS submitted that the Tribunal had been wrong to consider whether due diligence had been conducted by ESS on its immediate suppliers, let alone suppliers further up the chain. In support of that submission, she relied upon what Moses LJ had said in *Mobilx* at [75]. Counsel for HMRC submitted that it was clear from Moses LJ's judgment at [74]-[75] and [82] that Moses LJ was not saying that due diligence was irrelevant, but rather that Tribunals should not focus unduly on that question. I agree with that reading of Moses LJ's judgment.

Challenges to the Tribunal's findings of fact

24. ESS's first main challenge to the Tribunal's findings of fact is based on paragraphs 3-6 of the Tribunal's decision in which, as noted above, it set out a description of MTIC fraud. Counsel for ESS submitted that the Tribunal had proceeded on the basis that the features it described in that passage were essential for there to be an MTIC fraud; that this was incorrect, and MTIC fraud could take different forms; and that this misdescription tainted the whole of the remainder of the decision such that it could not be allowed to stand. She also submitted that the Tribunal had approached the appeal with the predisposition that ESS was fraudulent if its method of trading had any of the four characteristics of MTIC fraud listed in paragraph 6 of the decision.

25. As counsel for HMRC pointed out, however, paragraphs 3-6 of the decision are headed "Background…", and that is precisely what they are. Furthermore, I am not persuaded that there is any material inaccuracy in the Tribunal's account of a typical MTIC fraud or its characteristic features. Nor is there anything in paragraphs 3-6 of the decision to suggest that the Tribunal approached the case with the predisposition

that ESS was to be found to have acted fraudulently if its method of trading had any of the four characteristics referred to in paragraph 6 of the decision.

26. Counsel for ESS also submitted that, when taken together with the inaccurate description of MTIC fraud in paragraphs 3-6, paragraph 19 of the decision which I have quoted above was a further example of the Tribunal assuming that which had to be proved. I do not accept this. There is no connection between the Tribunal's description of MTIC by way of background in paragraph 3-6 of the decision and its exposition of the law in paragraph 19. Furthermore, paragraph 19 does not suggest that the Tribunal assumed that which had to be proved.

27. ESS's second main challenge concerns the Tribunal's finding in paragraphs 74-84 of the decision that the tax losses in question were attributable to fraud. There were four defaulting traders in the relevant supply chains, referred to in the decision as Samson, KEP 2004, Okeda and UK Communication. The Tribunal found that each of the defaults had been attributable to fraud, although in the case of KEP 2004 the basis of that finding was that KEP 2004's VAT number had been hijacked. ESS does not challenge the Tribunal's finding in respect of Okeda, but it contends that it was not open to the Tribunal to find fraud in respect of Samson, KEP 2004 and UK Communication since there was no evidence to support that finding.

28. As is pointed out above, however, it is not open to this Tribunal to conduct a review of the evidence to see whether it would have reached the same conclusion as the Tribunal below. Although counsel for ESS disclaimed any intention of seeking to re-argue the matters decided by the Tribunal and stressed that it was her submission that there was no simply no evidence to justify the Tribunal's findings, it is telling that she supported her submissions by reference to her written closing submissions for the Tribunal. Unsurprisingly, counsel for HMRC responded in kind. In reality, therefore, ESS is asking this Tribunal to review the evidence with a view to persuading it to reach a different conclusion to that reached by the Tribunal below. That is not an appropriate basis upon which to challenge the Tribunal's conclusions. In any event, having been taken by counsel through the evidence relied upon before the Tribunal, I am satisfied that there was evidence which entitled the Tribunal to make the findings it did.

29. ESS's third main challenge is to the Tribunal's finding that it had actual knowledge that its purchases were connected to fraudulent evasion of VAT. Again, counsel for ESS submitted that the Tribunal was not entitled to make this finding since there was no evidence to support it. Counsel's submissions in support of this ground of appeal involved a wide-ranging attack upon the Tribunal's reasoning on the relevant part of the decision. Once again, I consider that in reality counsel's argument amounted to an invitation to this Tribunal to review the evidence before the Tribunal below and reach a different decision. Again, that is not a proper basis for an appeal to this Tribunal. Given the importance of this issue to ESS, however, I will nevertheless briefly summarise the principal points made by counsel for ESS and my reasons for concluding that, contrary to those submissions, there was evidence which entitled the Tribunal to make the findings that it made.

30. The Tribunal's reasoning on this issue in paragraphs 85-115 of the decision may be summarised as follows. In paragraphs 86 and 87, which I have quoted above, the Tribunal considered what HMRC had to show. In paragraphs 88-98 the Tribunal

considered the deals as a whole and the pattern of trading which emerged from those deals. The Tribunal concluded that ESS's purchases had formed part of a series of back-to-back transactions which were uncommercial and which displayed a number of features of MTIC fraud.

31. Among the reasons the tribunal gave for reaching these conclusions were the following:

i) the same parties were repeatedly involved in the various supply chains;

ii) in most cases ESS had purchased the goods from one supplier, 21st Trading, whereas it had a considerable number of suppliers for its sales in the domestic market;

iii) the goods were repeatedly sold in the same quantity within a very short period of time;

iv) the profit margin was constant on each deal with a number of traders higher up the chain having a profit margin of 5p or 10p or 25p per unit, whereas ESS had a mark up of either £2 or £5;

v) some of the parties higher up the supply chain had banked with First Curacao International Bank;

vi) the timing of the payments between the various suppliers were of questionable commerciality, in particular because a number of parties in the chain had retention of title clauses and yet released the goods before receiving payment;

vii) some parties within the chain had made third party payments;

viii) there was evidence that the supplier of the goods had the details of one of the traders halfway up the chain called Qiass, suggesting that the intervening traders were simply there to lengthen the chain;

ix) there had been a significant increase in ESS's turnover in the relevant timeframe, which coincided with increased trading with two particular suppliers for export sales and a change in the export business of ESS compared to that previously undertaken by a related company called to ESL to sales to countries outside the EU;

x) a large number of deals conducted by 21st Trading in one of the relevant VAT periods had been traced back to a defaulting trader and a loss of tax;

xi) the same freight forwarder, namely Forward Logistics (Heathrow) Ltd ("FL"), was used in each transaction to store the goods prior to export;

xii) there was evidence that in some instances ESS's customer knew ESS's supplier, and yet bought from ESS;

xiii) ESS only traded with suppliers on terms that ESS acquired title upon release of the goods to it, which the Tribunal accepted in itself was sound commercial

practise, but the result was that no party in the chain of supply received payment until ESS had been paid;

xiv) it appeared in at least some instances that there was no end user for the goods;

xv) although ESS attributed its increase in turnover to attendance at trade fairs such as Cebit and developing contacts at those fairs, there was no clear evidence that such contacts resulted in an increase in overseas sales and in particular the significant increase in ESS's turnover; and

xvi) significant quantities of goods passed through the entire chain of companies in one day and did not leave the freight forwarders until their export.

32. The Tribunal's conclusion in paragraph 97 was that:

> "The features of the transaction suggest they did not come about in a normal commercial way but were predetermined in terms of profit, quantity and sales."

33. In paragraph 99 of the decision the Tribunal considered ESS's contention that the unusual features of the transactions were explicable as a result of the fact that it was trading in the grey market for CPUs. The Tribunal was not persuaded that this was the case.

34. In paragraphs 100-105 the Tribunal considered the due diligence undertaken by ESS. ESS's due diligence consisted of:

i) a Europa VAT number check;

ii) a VAT registration check at Redhill;

iii) a trading application form filled in by prospective customers and suppliers; and

iv) a site visit form recording visits to potential suppliers and customers.

35. ESS did not carry out any other checks, and in particular did not carry out credit checks on either their overseas customers or their suppliers for the export trade. The Tribunal concluded that in paragraphs 102 and 103 that, given that it was well known that there was significant fraud in the industry and in view of HMRC Notice 726, it would have been reasonable and proportionate for a trader in the position of ESS to carry out further checks, and in particular credit checks in respect of ESS's suppliers and customers.

36. In paragraph 104 the Tribunal recorded that the evidence showed that FL had carried out so called "closed box inspections" of the products, and that the inspection reports showed that most of the boxes inspected on behalf of ESS were in average to poor condition, suggesting that the boxes and therefore the goods were not new and may have been handled several times. In spite of the condition of the boxes, ESS had always accepted the goods and never questioned the suppliers about the condition of the boxes.

37. In paragraphs 106-115 the Tribunal summarised the position regarding ESS's knowledge of fraud. In paragraph 107 the Tribunal found that it was clear that there was evidence of a scheme to defraud HMRC and summarised its reasons for that conclusion.

38. In paragraph 108 the Tribunal found that it was clear that the directors of ESS were aware of MTIC fraud as far back as 2001, having closed a previous business of theirs, referred to as ESL, for that reason. They were also aware of Notice 726. The Tribunal concluded:

> "From the pattern of the transactions in which they were involved, the Tribunal believes, on a balance of probabilities, that the Appellant knew that the transactions were not legitimate. They may not have known the identity of the defaulting trader but they are likely to have known there was a missing trader somewhere in the chain and of a connection of that transaction to their transactions. The chain of transactions were planned and the clear inference is that the participants had actual knowledge of the fraud."

39. In paragraph 109 the Tribunal referred to the increase in turnover of ESS and its coincidence with export sales outside the EU and in having 21st Trading as a major supplier. Although ESS had carried out some due diligence, it had not carried out third party credit checks on its suppliers and customers which would have raised queries about the financial viability of the suppliers in particular.

40. In paragraph 110 the Tribunal considered that the information about the quality of the boxes from the closed box inspections amounted to "warning signs which should have alerted the Appellants that all was not right".

41. In paragraphs 111 and 112 the Tribunal referred to the reasons given by Mr Shaunak on behalf of ESL in a letter dated 8 August 2001 for ESL ceasing to trade on account of the risk of VAT fraud, and commented that it seemed strange that the directors of ESS would see fit to enter the market in 2004 when VAT fraud had if anything, increased.

42. In paragraph 113 the Tribunal returned to the question of the reason for ESS's unprecedented increase in business in the period under review. The Tribunal again accepted that ESS had visited trade fairs, but noted that there was no supporting increase in marketing or other marketing initiatives, the obtaining of product exclusivity or competitive contract negotiations. The Tribunal concluded that, given ESS's experience of the market, the transactions in which they were involved with the significant mark-up would have appeared too good to be true and should have raised concern. Furthermore they noted that ESS had relied heavily on two suppliers rather than shop around for competitive prices. Furthermore, when they stopped trading with 21st Trading, they started to trade with a competitor namely Miaotech with whom they did not have a previous relationship. Furthermore 21st Trading was a trade reference for Miaotech which the Tribunal considered strange.

43. In paragraph 114 the Tribunal referred once again to features of the transactions which led them to conclude that they were "contrived". The Tribunal concluded:

> "The evidence suggests that the Appellants were more willing to overlook shortcomings in the transactions and did not heed warning signed of suspicion because they knew the transactions were connected to fraud and they were willing participants."

44. The Tribunal expressed its final conclusion in paragraph 115 as follows:

> "The directors, at the time of entering into the transactions had substantial experience and knowledge of the industry. They understood the transactions with which they were involved. The trading revealed a pattern which, without substantial explanation provided by the Appellant allows one to draw the inference of dishonesty. The Appellants have not rebutted the case which has been put to them. The evidence of Mr Shaunak was not convincing or credible. He understood MTIC fraud but asserted that he did not understand how it worked or operated. The Tribunal believes that he knew more than he disclosed at the hearing. The transactions were without commercial substance and are contrived. The Tribunal has no hesitation in saying that directors of ESS, Bharat Shaunak and Moshin Darr, were fully aware of the risk inherent in trading substantial quantities of CPUs and of the fraud in that industry and they knew the transactions which they undertook in the VAT periods 04/06 and 05/06 were part of the scheme to defraud the Revenue."

45. It is important to note that the Tribunal found that the evidence of Mr Shaunak was not credible. This finding was not attacked by counsel for ESS, nor could it have been. As counsel for HMRC pointed out, this inevitably makes it difficult for ESS successfully to challenge the Tribunal's conclusion of actual knowledge.

46. The first main point taken by counsel for ESS was that the Tribunal had ignored the fact that ESS could not know the identity of the suppliers further up the chains who supplied its immediate suppliers, namely 21st Trading and then Miaotech. It followed, she submitted, that ESS could not undertake due diligence on those beyond its immediate suppliers and that ESS could not have known either the terms and conditions of business of the traders further up the chain or when they were paid. As counsel for HMRC submitted, however, there are two flaws in this submission.

47. First, the Tribunal did not find that ESS did know of the identity of the suppliers further up the chain, nor did it find that ESS knew their terms and conditions of business or when they got paid. Rather, the Tribunal examined the chains as a whole and concluded that they amounted to a contrived series of transactions. The Tribunal considered that the contrived nature of the transactions gave rise to the inference that those participating in these transactions knew that there was a fraudulent scheme to evade VAT. In addition, the Tribunal concluded that there were specific features of the transactions and circumstances which were known to ESS which supported that conclusion. It is immaterial to that reasoning that ESS did not know the identity of the traders further up the chain, if indeed that was the case.

48. Secondly, there were at least three kinds of checks which ESS was able to undertake which would have revealed information about the trade further up the chain. Indeed, ESS did in fact undertake two of them. The first was that ESS's own evidence was that it always checked the serial numbers of the CPUs offered to it to see whether it had purchased them before, and in some cases it found that it had been offered the CPUs before and rejected them. As counsel for HMRC submitted, this in and of itself was a clear indication to ESS of goods being resold and hence of MTIC fraud in its supply chain. Secondly, there were the inspections of the boxes. The fact that the majority of the boxes were found to be in poor condition indicated that the goods had been repeatedly moved and that there was a long supply chain. It was also inconsistent with the high demand to which ESS attributed the profitability of the deals in question. Thirdly, ESS could have enquired of FL how long the goods had been in the country and how many times the goods had changed ownership or possession while warehoused at its premises. Again, this information would have revealed a long supply chain. In addition to these general points there was the point which the Tribunal noted in paragraph 113 that, when ESS changed suppliers from 21st Trading to Miaotech, 21st Trading acted as a trade reference for Miaotech. This showed that in some cases it was possible for ESS to obtain information beyond its immediate supplier.

49. The next main point taken by counsel for ESS was that there were a series of factors in the present case which pointed away from the conclusion that ESS had known that its purchasers were connected with fraud and which the Tribunal had ignored. By way of example it was submitted that among these factors were that ESS had identified a new market as a result of attending trade fairs, that the volume of trade of ESS was not abnormally high, that there was a grey market where normal commercial rules might not be applicable and that ESS had protected itself by its own terms and conditions of business. The short answer to this submission is that, as can be seen from my summary above, the Tribunal did carefully consider each of these points. It was not persuaded that these led to the conclusion that ESS neither knew nor should have known that its purchasers were connected with fraud. On the evidence, that was a conclusion which it was entitled to reach.

50. Next, counsel for ESS submitted that the Tribunal had not been justified in concluding that the transactions in questions were too good to be true. ESS's mark up was either £2 or £5, out of which it had to pay for insurance and shipping in addition to the cost of the freight forwarders for storage and inspection. She submitted that this was not a large profit margin and certainly not one that could be described as too good to be true. As the Tribunal noted at paragraph 89 of its decision, however, ESS's mark up exceeded that of any other traders in the chain by a factor of between 8 and 100. The Tribunal did not accept that the extra costs incurred by ESS of insurance and shipping explained this discrepancy. The Tribunal was entitled to take that view given that the evidence before it showed that the additional costs attributable to insurance and shipping were of the order of pence rather than pounds. Furthermore, as the Tribunal found at paragraph 96 of its decision, the standardisation of mark-up in itself gives rise to suspicion. Counsel submitted that consistency in mark-up further up the chain could not be relevant to the state of ESS's knowledge. However, the Tribunal considered that the standardisation in mark-up further up the chain was one of the indications that the transactions were contrived. Furthermore, the standardisation of

mark-up regardless of the quantity of the goods being sold to which it drew attention also applied to ESS's own sales.

51. Next, counsel for ESS submitted that the Tribunal had failed to address the circumstances in which ESS's transactions had taken place. In this regard she relied on the facts that ESS had been in the computing business for many years, that it owned its own premises, that it banked with Barclays Bank, it did not demand third party payments and that it found its own customers and suppliers. As counsel for HMRC pointed out however, most of these matters relate to ESS's separate, established domestic business. The Tribunal's findings relate to the new export business which ESS commenced at the end of 2004, which as the Tribunal found had a number of characteristics which differentiated it from ESS's established domestic business. In addition, it is not accurate to say that ESS always found all of its own customers and suppliers. In particular, Miaotech introduced itself to ESS.

52. Next, counsel for ESS submitted that the Tribunal had failed to identify objective factors by which ESS knew or should have known of the fraud. I do not accept this submission. On the contrary, as I have summarised above the Tribunal did identify objective factors which led it to the conclusion that ESS was aware that its purchases were connected with fraud. Again, counsel for ESS's submissions under this heading amounted to an invitation to this Tribunal to review the evidence before the Tribunal and reach a different conclusion. For example, she submitted that the evidence showed that ESS's transactions were commercial rather than uncommercial. Once again, this is a matter which was fully considered by the Tribunal in its decision. It concluded that the transactions were uncommercial for the reasons which it gave. It was entitled on the evidence to reach that conclusion.

53. Finally, counsel for ESS attacked a number of the Tribunal's other findings as having been unsupported by the evidence. By way of example, she contended there was no evidence to support the Tribunal's finding that all of the deals conducted by 21st Trading in the VAT period 04/06 had been traced back to a defaulting trader and a loss of tax. As counsel for HMRC pointed out, however, there was evidence to that effect before the Tribunal. The quality and weight of that evidence were a matter for the Tribunal to assess. Counsel for ESS raised a number of other points of a similar nature. It is not necessary to go through them individually. My conclusion in respect of all of them is the same.

54. In summary, I consider that there was evidence before the Tribunal from which it was entitled to conclude that ESS had actual knowledge that its purchases were connected with the fraudulent evasion of VAT.

Conclusion

55. For these reasons the appeal is dismissed.

Mr Justice Arnold

Release Date: 23 July 2010