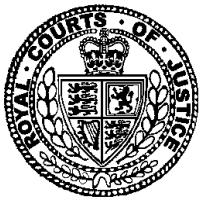

[2014] UKUT 0307 (TCC)
APPEAL NUMBER FTC/83/011

VAT – Missing Trader Inter-Community fraud, contra-trading, whether the appellant knew or should have known that the transactions were connected to fraudulent evasion of VAT. Did the FTT apply the right test? Yes. Appeal dismissed.

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

- -

TOTEL DISTRIBUTION LIMITED **Appellant**

- and -

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

- -
- -

TRIBUNAL: MRS JUSTICE PROUDMAN DBE

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 10 June 2014

Vivienne Tanchel instructed by Litigaid Law, solicitors, for the Appellant
Jeremy Benson QC and Joshua Shields instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by Totel Distribution Limited ("the company") against the decision (after an 11 day hearing and written submissions) of the First-tier Tribunal ("the FTT") (Mr Richard Barlow, Rayna Dean FCA and Peter Whitehead) released on 31 March 2011 which found in favour of HMRC. That was itself an appeal by the company against HMRC's refusal to allow VAT input claims totalling some £2.87m in respect of accounting periods in 2006. The FTT refused permission to appeal on 9 August 2011 but permission to appeal was granted by the Upper Tribunal (Judge Theodore Wallace) on 3 October 2011. The reason for the delay since then is that the appeal was stayed pending references to the European Court of Justice which are irrelevant as the company proceeds on its original grounds of appeal.

2. The company was represented before me by Miss Vivienne Tanchel and HMRC by Mr Jeremy Benson QC and Mr Joshua Shields. I repeat the FTT's thanks and praise to them for their presentation of the case.

3. HMRC's contention is that the input tax arose from transactions connected with the fraudulent evasion of VAT, a so-called Missing Trader Intra-Community ("MTIC") fraud, about which the company either knew or should have known. The allegation is one of contra-trading by the company's suppliers. It is said that although the company's transactions were not themselves directly part of a chain of transactions in which there was a fraudulent tax loss, those transactions were connected with other chains in which there was a such a loss and that the company's transactions had assisted in the fraud in those so-called "dirty" chains. Put very briefly, HMRC alleges that the company's suppliers had input tax claims arising in the course of the suppliers' involvement in fraudulent chains. In those chains other traders had failed to account for input tax so that the suppliers' claims for input tax were not matched by any payment of input tax elsewhere in the chain. The alleged purpose of the company's involvement was that the transactions in which the company bought goods from the suppliers created output tax liabilities which offset and thus disguised the existence of the fraudulently claimed input tax because the suppliers' tax returns would not appear to consist of a large repayment claim. Thus it is argued that it was less likely that HMRC would make inquiries.

4. The sole issue before the FTT, and thus the only issue on this appeal, is whether the company "knew or should have known" that the transactions giving rise to input tax repayment claims were transactions "connected with fraudulent evasion of VAT". That they were so connected (as a matter of hindsight) was accepted before the FTT so that knowledge was the only issue. It was also accepted that Mr Keith Rowbotham was the sole director of the company and thus that his knowledge was the company's knowledge.

5. The FTT made a finding of actual knowledge on Mr Rowbotham's part but, at [87], it also held that he should have known that the transactions were connected with fraud:

> "…he subjectively knew that the transactions were connected with fraud not just that the objective characteristics of the transactions meant that he ought to have known that fact (though we do also find that was the case)."

6. The FTT expressly purported to apply the test in *Mobilx, Blue Sphere Global and Calltel v. HMRC* [2010] STC 1436, basing its decision on all the evidence about the transactions. It considered that the differences between the terms of the contractual documentation and the manner in which the transactions were actually carried out was evidence that the company knew that the transactions were connected with fraud.

7. Mr Benson urged on me that the background to this case is that in a few days at the end of April, May and June 2006 the company, without the injection of any capital, made a profit of over £1.1m. That of course is by no means enough by itself for HMRC to have made out its case. I bear in mind that the burden of proof was on HMRC to prove that the company did have the relevant knowledge and although the standard of proof is the same in all civil cases, namely the balance of probabilities, the court's approach to allegations of fraud must be particularly careful and cautious.

8. An appeal to the Upper Tribunal only lies on a point of law: section 11 of the Tribunals, Courts and Enforcement Act 2007. An appeal may only succeed if the appellant satisfies the Upper Tribunal that the findings in question amount to errors of law on the basis that they were inconsistent with the evidence and contradictory to it: see *Edwards v Bairstow* [1956] AC 14. The court will not entertain, under the guise of a question of law, "a disguised attack on findings of fact": see *Georgiou v. Customs and Excise Commissioners* [1996] STC 463 at 476 per Evans LJ. The Upper Tribunal cannot conduct a review of the evidence to see if it would have reached the same conclusion. It is not in a position to assess the oral evidence that was before the FTT. I note in particular that in this case there were several days of oral evidence; for example Mr Rowbotham gave evidence for three and a half days. Particular circumspection is needed where, as here, I was invited by the company to consider small portions of a large body of evidence which had been before the FTT. It is one thing to review the conclusions of law reached by the FTT on the basis of the facts which it found; it is another to substitute one's own conclusions for the "multi-factorial assessment" or value-judgment reached by the Tribunal, having heard a large body of evidence, as a matter of inference from those facts.

9. Evans LJ went on at 476 of *Georgiou* to set out a four-stage process for examining challenges to findings of fact, as follows:

> "…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."

10. In *Megtian Limited v. HMRC* [2010] EWHC 18 (Ch) Briggs J summarised the law in this area at [11] as follows:

> "There are numerous authoritative statements of the precise meaning of the concept that a finding of fact involves an error of law when it is based upon non-existent or inadequate evidence. They were recently summarised by Christopher Clarke J in *Red 12 Trading Ltd v. HMRC* [2009] EWHC 2563 (Ch) at paragraphs 113-120. The question is not whether the finding was right or wrong, whether it was against the weight of the evidence, or whether the appeal court would itself have come to a different view. An error of law may be disclosed by a finding based upon no evidence at all, a finding which, on the evidence is not capable of being rationally or reasonably justified, a finding which is contradicted by all the evidence, or an inference which is not capable of being reasonably drawn from the findings of primary fact."

11. In *Kittel v. Belgium; Belgium v. Recolta Recycling SPRL* (joined cases C-439-04 and C440/04) the ECJ set out the circumstances in which in the context of MTIC fraud a revenue authority is entitled to deny a claim for repayment of input tax. The Court said,

> 56. …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'."

12. The Court of Appeal (Moses LJ with whom the other two members agreed) gave guidance on the application of *Kittel*: "The test in *Kittel* is simple and should not be over-refined."

The Grounds of Appeal

Ground 1

13. Ground 1 is that in reaching its decision as to actual knowledge, the FTT came to a conclusion that no reasonable Tribunal, directing itself properly as to the law, could have come to. It is said that the FTT made findings of fact and drew inferences not capable of being rationally or reasonably justified.

14. It is not alleged that it was not open to the FTT to make the relevant findings of fact, but that inconsistent findings coloured the FTT's view of the evidence as a whole.

15. It is said that it was inconsistent to find, on the one hand, that Mr Rowbothan was an experienced and intelligent businessman, "by no means naive in business life" while on the other finding (at [56]) that he had "only a poor understanding of the concepts of possession and title to goods and of the difference between those concepts".

16. However, Mr Benson countered that there is no inconsistency between the two findings. Mr Rowbotham was unable to understand or explain the difference between title and possession for the simple reason that the transactions were contrived rather than an element of a bona fide commercial enterprise. The confusion arose because of the opaque way in which the business was carried out.

17. The company's skeleton argument identifies another area in which it is said that Mr Rowbotham was confused, namely as to anomalies in the deal documentation. However, the cross-examination exposed that the documents disclose that the deal could not have happened in the way Mr Rowbotham described. That was the point of the cross-examination, and it cannot be an answer to the FTT's finding that Mr Rowbotham manifested incomprehension under cross-examination.

18. As to the finding that Mr Rowbotham was dishonest, it is said, again, that apparent lack of candour on his part coloured the FTT's findings as a whole. Thus the evidence he gave on, for example, re-negotiation of the terms of

trading, the due diligence steps he took and his understanding of the manner in which the deals were done were, it was said, viewed with scepticism that was unfounded. Once the FTT had erroneously disbelieved him it was unable objectively to evaluate the evidence. For example, in [52] the FTT dismissed Mr Rowbotham's evidence about additional due diligence as, "amounting to little more than assertions that he had met the people concerned". There was no such lack of candour, submitted Miss Tanchel, and if there appeared to be inconsistencies in the evidence, they should have been put fairly and squarely to Mr Rowbotham. In [84] of its decision, the FTT said,

> "Mr Rowbotham was asked at the end of his evidence for an explanation of how the appellant's counterparties came to know what were the special terms on which they dealt with the appellant. He then claimed that he spelled out to those counterparties what the terms were. He had not given that explanation earlier in his evidence and we reject it."

19. Miss Tanchel took me to a number of passages in the oral evidence (in Day 8) in which Mr Rowbotham stated that he and the counterparties had verbally discussed the terms on which they were dealing. However, I agree with Mr Benson that these passages are taken out of context. The special terms mentioned appear in the answers to questions asked of Mr Rowbotham by Judge Barlow over some five pages of the transcript, such as, "How did you become aware of what the understandings and the unwritten agreements and the verbal agreements which were not even always spelt out verbally were?" The terms referred to in the passages to which Miss Tanchel took me were the basic terms of the transaction, model number, price, routes. In answer to the FTT Judge's questions, Mr Rowbotham said that special terms were incorporated into contracts by "understanding" and then, apparently, by express verbal agreement. The FTT was entitled to find that, had there been express discussion of the terms, Mr Rowbotham would have mentioned it earlier. Thus the FTT was entitled to reject as fabricated his answers as to the special terms.

20. Miss Tanchel also relied on the fact that Mr Rowbotham said that with the assistance of Mr Nielson he carried out some due diligence and that the FTT ignored his statements that he had started due diligence before a transaction was carried out although he had completed it afterwards.

21. It was common ground that due diligence is a relevant factor although only one relevant factor. Indeed the FTT was plainly acutely aware of what Moses LJ had said about it in *Mobilx*: see [53] of the decision. However, the FTT did not ignore the fact that in some cases the company had started the due diligence process before the transactions. The FTT expressly deals with this in [49], saying,

> "Mr Rowbotham said in his second witness statement that in some cases [his words] the appellant's due diligence enquiries "would have begun before the deals were done but not completed until after the deals were concluded". He appears therefore to admit that there were deals where no due diligence was done before the deals were done and it is certainly the case that on his own admission he paid little if any attention to the credit ratings or other indications of the financial strength of the appellant's counterparties relying almost entirely on the benefits of dealing on ship on hold terms…"

22. The FTT found it significant that the company traded with some counterparties before receiving due diligence reports. It inferred that this due diligence was obtained for the sake of appearances (the company was put on notice by HMRC that due diligence documentation had to be obtained) so that the FTT was entitled to view it as an indicator of activities carried out other than for bona fide commercial reasons. Evidence of uncommercial activity was clearly germane to its decision.

23. It is not right that, in not mentioning the due diligence carried out by the company, the FTT must have disregarded it. The FTT dealt with due diligence in some detail and it is not obliged to deal with every document provided by an appellant. In any event, the due diligence which it is said was not taken into account (confirmation of the trading partner's VAT number and supplier declarations) was not compelling.

24. The significance of Mr Rowbotham's failure to identify what inquiries he had made of counterparties lies in the inference that such inquiries did not matter because the trading was contrived. All of the facts need to be, and were, taken into account and viewed together to build up a picture of what the company knew or should have known.

Ground 2

25. It is said that the FTT erred in law in finding actual knowledge. It was necessary for a trader to know the explanation for the transaction in which he was involved and that it was connected with fraud. Mr Rowbotham's evidence was that he was not aware (and indeed the officers of HMRC were not aware) of the details of contra-trading. Thus it could not have been proved that the transaction in which he was involved, the "clean" chain, was connected with fraud in the "dirty" chain.

26. However, it is plain from the judgment of Briggs J in *Megtian* that HMRC do not have to show knowledge of any particular type of fraud; knowledge of connection with fraud is all that is required. In *Powa (Jersey) Limited v. HMRC* [2012] STC 1476) Roth J quoted from Briggs J's judgment, in which Briggs J said the following:

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

Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes…"

27. Roth J himself said (without criticism from the Court of Appeal which refused permission to appeal) at [52]-[54],

"I do not see that there is any requirement that PJL [the appellant] should reasonably have known the identity of the contra-trader. HMRC must establish that fraudulent evasion of VAT took place, and if the form of fraud involved was contra-trading then that is what they have to prove. But it is a misconception to consider that they must also establish that the party seeking to deduct input tax (i.e. here, PJL) should reasonably have known that its own transaction was connected to (or involved in) this particular form of missing trader fraud as opposed to another form.…

In any event, it is clear from the Court of appeal judgment in *Mobilx*… that no special approach is required in a case involving contra-trading. The correct test as regards knowledge is always the same. It is the test derived from *Kittel* as set out on para[59] of Moses LJ's judgment….

…the FTT here emphasised that the test was "not whether PJL took adequate precautions, but whether it knew or had the means of knowing that its transactions were connected with fraud…Based on a thorough consideration of all the surrounding circumstances, it found that PJL knew or must have known that it was engaged in an artificial, contrived market, and that finding applies to the three transactions that were part of a contra-trading chain as much as to all the others."

28. I respectfully agree with Roth J that the only correct test is the *Kittel* test and that this was correctly applied by the FTT in the present case.

Ground 3

29. It is said that the FTT should have considered whether the company knew or should have known, in that it had the means of knowledge, that there was a fraud in the dirty chain. The company relies on the decision of Lewison J in *Revenue & Customs Commissioners v. Brayfal Limited* [2011] STC 1338 where he said at [19]

> "The essence of contra-trading is that transactions in the clean chain are used to mask transactions in the dirty chain. There is no fraud in the clean chain. The dirty chain is where the fraud takes place. Accordingly in order for a trader in the clean chain to know or have the means of knowledge that his transaction is connected with fraud, he must either know or have the means of knowledge that the contra-trader is the fraudster; or he must know or have the means of knowledge of the fraud in the dirty chain…"

30. I make the following comments on this passage. First, Lewison J was examining whether there was a legal error by the FTT on the facts of the case before him. The clean chain was created before the dirty chain so that there were difficulties for HMRC in proving that the taxable person at the time of his transaction knew or should have known that his transaction was connected with fraud. Thus Lewison J's decision was fact-specific. Secondly, he cites *Megtian* without criticism. Thirdly, Roth J approved Briggs J's approach in *Megtian* after *Brayfal* was decided. Fourthly, Lewison J was bound by and well aware of *Mobilx* and must be taken to have meant that the only relevant issue is knowledge of fraud. The reasoning in [9] of the FTT's refusal of permission to appeal is correct.

Ground 4

31. This ground alleges that the threshold applied by the FTT is too low. The company says that the FTT should specifically have asked itself whether there was any reasonable explanation for the transactions other than connection with fraud. It relies on the judgment of Moses LJ in *Mobilx* where he said at [59],

> "It embraces not only those who knew of the connection but also 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 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*."

and again at [74],

> "The ultimate question is… 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."

and again at [82],

> "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."

32. What Moses LJ said in *Mobilx,* logically goes to "should have known" rather than to actual knowledge. *Mobilx* was concerned with "should have known" and explained that it had the same meaning as in *Optigen Ltd v Customs and Excise Commissioners [2006] ECR I-483 C-354/0* at [55]. In the present case, the FTT found that there had been actual knowledge so that there was no need for the "only reasonable explanation" test. While it is true that the FTT found in the alternative that the company "ought to have known" of the connection with fraud its previous findings meant that it did not need separately to ask the question whether there was any reasonable explanation other than fraud for the transactions. I bear in mind Moses LJ's strictures that the test in *Kittel/Mobilx* is "simple and should not be over-refined".

Conclusion

33. It seems to me that under Ground 1 the company has attempted to isolate small points in the evidence and construct a case around them on the basis that they would have coloured and informed the FTT's view of the whole of the evidence. I do not forget that I heard half a day of argument on a case in which there were 11 days of argument and evidence below as well as written submissions. In my view there is nothing in the evidential points in any event.

34. As to the points of law, in my judgment the FTT considered all the evidence in reaching its conclusion of actual knowledge and applied the correct test, namely whether the company knew or should have known that the transactions giving rise to input tax repayment claims were transactions connected with the fraudulent evasion of VAT.

35. Accordingly I dismiss the appeal.

TRIBUNAL JUDGE: The Hon Mrs Justice Proudman DBE

RELEASE DATE: 07 JULY 2014