[2014] UKUT 0008 (TCC)

Appeal number
FTC/86/2012

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

ELSE REFINING AND RECYCLING LIMITED **Appellant**

- and –

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

Tribunal: The Hon Mr Justice Arnold

Sitting in public in London on 25 November 2013

Simon Baker, instructed by Mavin & Co, for the Appellant

Adam Hiddleston and Rupert Jones, instructed by the General Counsel and Solicitor to HMRC, for the Respondents

MR JUSTICE ARNOLD:

Introduction

1. This is an appeal from a decision of the First-Tier Tribunal (Tax) (Tribunal Judge John Walters QC and Mr Andrew Perrin FCA) dated 23 July 2012 ([2012] FTT 470 (TC)). By its decision the First-Tier Tribunal, which hereinafter I will refer to for brevity simply as "the Tribunal", dismissed the appeal of Else Refining and Recycling Ltd ("ERR") against a decision of the Commissioners of Her Majesty's Revenue and Customs ("HMRC") to deny ERR entitlement to the right to deduct input tax in the total sum of £234,442.39 in respect of five purchases of CPUs, mobile telephones and Apple iPods in the periods 07/06 and 08/06. The ground for that decision was that the input tax incurred by ERR arose from transactions connected with the fraudulent evasion of VAT (i.e. so-called Missing Trader Intra-Community or MTIC fraud) and that ERR should have known of that fact. The Tribunal's decision was given after an eight day hearing at which a number of witnesses gave evidence, including Anthony Else and Jason Else, the directors of ERR. It was common ground before the Tribunal that each of the transactions was in fact connected with the fraudulent evasion of VAT. The Tribunal accepted ERR's case that it did not know this at the time, but held that it should have known this.

Background

2. The Else family have been in the business of refining and recycling electronic equipment for a long time. Since 1992 the business has been conducted through ERR. The business includes sensitive work disposing of equipment for important public and private sector customers. This has at all times been ERR's core business, and one which ERR has always conducted with probity.

3. In May 2005 ERR branched out into a new field. This was as result of an approach from Lexus Telecom Ltd ("Lexus"), one of ERR's main suppliers of second-hand mobile phones. Lexus proposed that ERR should handle some of Lexus' export sales of new mobile phones. The reason why ERR understood that Lexus could not handle the export sales itself was that Lexus could not fund the VAT cost pending repayment by HMRC. Following this approach, ERR entered the export trade in mobile phones and other electronic products. In November 2005 ERR asked HMRC to move from quarterly to monthly VAT returns in order to reduce the delay in obtaining repayment of VAT on such exports. ERR entered into a number of transactions of this type before the ones in issue.

4. The transactions in issue are as follows:

   In the period 07/06 (the month ending 31 July 2006)

   (1) A purchase of 4,410 Intel P4 SL 7Z9 central processing units ("CPUs") from Maximise Services Ltd ("Maximise") – invoice date 10 July 2006 – VAT disallowed £48,928.95 ("Deal 1").

(2) A purchase of 500 Nokia 3220 mobile telephones from Maximise – invoice date 18 July 2006 – VAT disallowed £3,644.38 ("Deal 2").

(3) A purchase of 1,600 Nokia 6101 mobile telephones from Maximise – invoice date also 18 July 2006 – VAT disallowed £16,537.50 ("Deal 3").

(4) A purchase of 2,750 Nokia N90 mobile telephones from Exhibit Enterprise Ltd ("Exhibit") – invoice date 19 July 2006 – VAT disallowed £127,531.56 ("Deal 4").

In the period 08/06 (the month ending 31 August 2006)

(5) A purchase of 2,000 Apple iPods Nano 4GB units from Regal Portfolio Ltd ("Regal") – invoice date 30 August 2006 – VAT disallowed £37,800 ("Deal 5").

The Tribunal's decision

5. The Tribunal's decision is a careful and detailed one running to 78 numbered paragraphs. It is structured as follows: paragraphs [1]-[11] consist of an introduction in which the Tribunal identifies the issues to be decided and describe the evidence before it; paragraphs [12]-[54] set out the Tribunal's general findings of fact; paragraphs [55]-[63] set out the Tribunal's reasoning and conclusion on the issue of whether ERR had actual knowledge that the purchases were connected with the fraudulent evasion of VAT; paragraphs [64]-[77] set out the Tribunal's reasoning and conclusion on the issue of whether ERR should have known that the purchases were connected with the fraudulent evasion of VAT; and paragraph [78] sets out the Tribunal's disposal of the appeal.

The law

6. 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."

7. 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."

8. 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."

9. 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."

10. 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."

11. 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."

12. 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

13. Section 11(1) of the Tribunals, Courts and Enforcement Act 2007 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 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.

14. 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."

15. 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.
>
> 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."

16. 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 at [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] …."

17. 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. … "

The grounds of appeal

18. ERR challenges the decision of the Tribunal on two grounds. The first ground is that the Tribunal applied the wrong legal test. The second ground is that the Tribunal's decision was one that no person acting judicially and properly instructed as to the relevant law could have come, in other words, one that was not open to it on the evidence.

First ground of appeal

19. The Tribunal introduced the issues it had to decide as follows:

> "3. HMRC's decision was based on their opinion that the purchases referred to formed part of an overall scheme to defraud the revenue and that there were features of the transactions and the conduct of Else which demonstrated that Else knew or ought to have known that this was the case. In legal terms, HMRC allege that, having regard to objective factors, the supplies to (purchases by) Else referred to, were supplies to a taxable person (Else) who knew or should have known that, by the purchases, it was participating in transactions connected with the fraudulent evasion of VAT (cf paragraph 61 of *Axel Kittel v Belgian State, Belgian State v Recolta Recycling SPRL* (Joined Cases C-439/04 and C-440/04) [2006] ECR I-6161 ('*Kittel*').
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> 4. In England the Court of Appeal considered the proper interpretation of *Kittel* (a decision of the ECJ) and its application in *Mobilx v Commissioners for HMRC* [2010] EWCA Civ 517 ('Mobilx'). The Court of Appeal held (*ibid.* at [81]) that the burden lies upon HMRC to prove a trader's state of knowledge. Thus if HMRC prove that the trader in question actually knew that his (its) purchase has been or will be connected to fraud, that will be enough to deny the trader's entitlement to deduct the relevant VAT as input tax (the actual knowledge limb of the Kittel test). Alternatively, if HMRC prove that the only reasonable explanation for the circumstances in which the trader's purchase takes place is that the purchase has been or will be connected to fraud, then that also will be enough to deny the trader's entitlement to deduct

> the relevant VAT as input tax (the 'should have known' limb of the *Kittel* test)."

20. ERR contends that the last sentence of [4] misstates the legal test which the Tribunal was required to apply, since it states the test in objective terms ("if HMRC prove that the only reasonable explanation for the circumstances in which the trader's purchase takes place is that the purchase has been or will be connected to fraud") rather than in subjective terms in accordance with *Mobilx* at [59] ("if a trader should have known that the only reasonable explanation for the transaction in which he was involved was that the transaction was connected with fraud").

21. Furthermore, ERR contends that this was not a mere slip of the pen on the Tribunal's part, because the same misstatement appears at [64] and at [72]:

> "**Whether Else ought to have known of the connection with fraud – whether the only reasonable explanation for the circumstances in which the Deals took place was that they were connected to fraud**
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> 64. We have reached the clear conclusion that the only reasonable explanation for the circumstances in which Deals 1 to 5 inclusive took place was that they were connected to fraudulent evasion of VAT and the appeal fails on this basis.
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> …
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> 72. For these reasons we conclude that the only reasonable explanation for the circumstances in which Else's purchases in Deals 1 to 5 inclusive took place was that the purchases had been (or would be) connected to the fraudulent evasion of VAT. That is, in short, why the deals were 'too good to be true'."

22. HMRC accept that these parts of the decision could have been more accurately worded, but contend that, if the Tribunal's decision is read as whole and in context, it can be seen that the Tribunal did apply the correct test. HMRC rely on the following points. First, it was common ground between the parties before the Tribunal that the test to be applied was that stated in *Mobilx* at [59]. Secondly, the Tribunal accurately stated at [3] that HMRC alleged that ERR "knew or should have known that, by the purchases, it was participating in transactions connected with the fraudulent evasion of VAT". Thirdly, the Tribunal accurately stated in the second sentence of [4] that the Court of Appeal had held in *Mobilx* that "the burden lies upon HMRC to prove a trader's state of knowledge", and the last sentence must be read not only in that context but also taking into account the reference to "the 'should have known' limb of *Kittel*". Fourthly, the Tribunal accurately stated at [7] that the only issues for its decision were "whether, in terms of *Kittel* and *Mobilx*, HMRC have proved that, on the balance of probabilities, Else knew or alternatively should have known that its purchases in Deals 1 to 5 inclusive were (rather than were probably) connected with fraud". Fifthly, in the

heading to [64] the Tribunal correctly referred to whether "Else ought to have known of the connection with fraud". Sixthly, in the passage following [64], the Tribunal repeatedly focussed upon what ERR knew or should have known. By way of example, at [68] the Tribunal referred to "the fact which should have been obvious to AE and JE at the time of the deals, that they involved a supply chain of at least 5 entities, which because of the subdivision of the total profit commercially available on the supply of these products among participants in the chain of supply, was an indication that the chain was fraudulent", at [74] the Tribunal stated that it did not accept that a submission made by counsel "prevents us from regarding the aspects of the Deals in question as evidence that Else ought to have known that they were connected to fraud" and at [77] the Tribunal stated that they considered it "idle to suggest … that if AE or JE had read the reports carefully, they would not have known that there was no reasonable explanation … other than that the transactions proposed were connected with fraud".

23. ERR contends in reply that, while the Tribunal may appear to have stated the test correctly in parts of the decision, the references relied upon by HMRC indicate that the Tribunal wrongly conflated the objective and subjective tests.

24. Having considered the Tribunal's decision as a whole, I consider that it is clear that it did apply the right test. In my view ERR's challenge is based upon a textual analysis of isolated parts of the decision that is unfair to its author.

Second ground of appeal

25. The reasons given by the Tribunal for concluding that ERR should have known that the transactions were connected with fraud may be summarised as follows:

    (i) The deals were "too good to be true" in terms of the profit to be earned for so little work done ([65]-[67], [73]).

    (ii) ERR undertook insufficient due diligence ([67]). In particular, the Tribunal listed the following checks which were not undertaken by ERR:

        (a) not obtaining trade references from suppliers and customers;

        (b) not making personal contact with representatives of suppliers and customers;

        (c) not making initial visits to suppliers' premises;

        (d) not recording IMEI numbers;

        (e) not checking supplier declaration forms;

        (f) not checking the accuracy of inspection reports;

        (g) not obtaining up-to-date Redhill checks; and

(h) not having written contracts with suppliers specifying dates of payment and a returns policy for damaged or faulty goods.

(iii) The fact that there was a lack of specificity as to the details of the goods being traded ([68], [75]).

(iv) The fact that inspection reports showed that the chargers for the mobile telephones were equipped with two-pin chargers which were unsuitable for use in the UK, thereby raising the question of why the goods were in the UK ([68], [75]).

(v) The fact that there were at least five traders in the chains between manufacturer and end user with no obvious commercial justification ([68], [75]).

(vi) The fact that suppliers involved in the chains (including ERR) were willing to release goods and incur shipping costs without payment while purporting to retain title against payment, with the effect that ERR and others effectively sold goods they did not own ([68]).

(vii) The fact that ERR was careless about the likelihood that Deals 1-5 might be connected with fraudulent evasion of VAT, the predominant cause of which was ERR's failure to understand the nature of the danger ([69]-[70]). This was because Anthony Else regarded the danger of becoming involved in chains of suppliers affected by fraudulent VAT evasion as being limited to a danger of dealing directly with a dishonest trader ([33]-[34]).

(viii) The fact that ERR could and should have obtained reports from a company called Veracis Ltd on Maximise, Exhibit and Regal prior to entering into the deals. ERR had obtained such reports, but only after the event when it was too late. If they had obtained such reports in time, ERR would have discovered that all three suppliers had achieved first-year turnover figures (about £80 million in the case of Maximise, about £60-100 million in the case of Exhibit and about £60 million in the case of Regal – [50]) which Anthony Else had accepted were "staggering" ([77]). ERR would also have discovered these turnovers had been achieved in the case of Maximise by a company with only two employees and in the case of Regal from premises rented monthly from a university ([50]).

26. ERR contends none of these factors, whether considered individually or cumulatively, was capable of justifying the Tribunal's conclusion that ERR should have known that the transactions were connected with fraud.

27. I will consider each of these factors in turn. Before doing so, however, I would comment that it is clear that the Tribunal reached its decision on the basis of their cumulative weight and in the light of its earlier findings of fact.

28. *"Too good to be true"*. ERR contends that the Tribunal failed to consider whether the profitability of the transactions was inconsistent with ERR's belief

at the time of entering into the transactions that such profits were normal for the grey goods market. In particular, ERR criticises the Tribunal's reasoning at [74]. In order to put this in context, it is necessary to quote the paragraphs before and after that paragraph:

> "73. In reaching this conclusion we believe we have avoided the error of judging the evidence with the benefit of hindsight. Deals 1 to 5 inclusive could have been seen at the time to be 'too good to be true' by reference to circumstances objectively ascertainable at the time the deals were done – the high gross profit, the little work needed to be done to earn it, the ease of implementing the deals in the casual way the business was conducted and the lack of specification of the products dealt in – to mention only a few aspects.
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> 74. We do not accept Mr de Silva's submission that the fact that Deals 1 to 5 were typical of grey market trading at the time, combined with HMRC's acceptance that not all trade in the grey market in mobile telephones and electronic goods in 2006 was fraudulent, prevents us from regarding the aspects of the Deals in question as evidence that Else ought to have known that they were connected to fraud and that this was the only reasonable explanation for the circumstances of the Deals. The answer to this point is in our judgment contained in a passage of Officer Stone's evidence (which was not challenged at the hearing) in which he says:
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> > 'I do not doubt that there is a genuine grey market in mobile phones which exists to meet the needs of consumers. But I do doubt that this market accounts for more than a relatively small proportion of the wholesale mobile phone trade quantified in the table [included in his evidence]. As described above, the overall volume of trade has risen and fallen at the same time as the promulgation of key ECJ judgments and the introduction of key anti-MTIC measures …'
>
> 75. It is not, in our judgment, a reasonable explanation of the circumstances of the Deals that they were deals in chains of genuine grey market trading existing to meet the needs of consumers. They were not deals in such chains and the fact, for example, that it was objectively ascertainable at the time the deals were done that there were (at least) 5 entities in the relevant supply chains makes unreasonable any inference, made at the time, that they might have been deals in chains of genuine grey market trading. The same conclusion can be drawn from other aspects of the deals as itemised above including the lack of specification of the goods being traded, and the fact that inspection reports showed that mobile telephones involved were equipped with two-pin chargers, unsuitable for use in the UK and therefore raising the question

> why they were in the UK and being sold to Else by a UK trader."

29. Counsel for ERR submitted that, despite warning itself of the danger of hindsight, the Tribunal had fallen into that very trap at [74], since the information provided by Officer Stone was not known, and could not have been known, to ERR at the time. I accept that point. In my judgment, however, it does not detract from the Tribunal's conclusion at [73].

30. The Tribunal's conclusion at [73] was that the profitability of the deals in question was "too good to be true". This was based on its earlier reasoning at [65]-[68] and the findings of fact it had made previously. As indicated above, the Tribunal found that ERR was relatively new to this market at the time of the transactions in question. It also found that it had entered the market after an approach from Lexus which the Tribunal found to be "unusual, if not bizarre" (at [31]), one which was "non-commercial" (at [32] and [60]) and one which "should on any view of Else's knowledge at that time have put Else on enquiry" (at [32]). It also found that on 10 July 2006 ERR had entered into a transaction whereby it purchased mobile phones and sold them to Lexus in the UK ("Deal 6") at a much smaller profit than it gained on Deal 1, which the Tribunal considered was evidence that "Else appears to have been peculiarly ready to oblige Lexus" (at [46]). Thus it is questionable on what basis ERR concluded that the high profits on the deals in question were normal for the grey market. In any event, the Tribunal considered that a number of features of the transactions should have led ERR to realise that the profitability of them was "too good to be true". In my judgment there was evidence before the Tribunal which it entitled it to reach that conclusion even disregarding Officer Stone's evidence.

31. Furthermore, I do not think that the Tribunal relied on Officer Stone's evidence as supporting the conclusion it reached at [73]. Rather, it relied on Officer Stone's evidence as supporting the conclusion it reached at [75], namely that a number of features of the transactions which were known to, or ascertainable by, ERR were inconsistent with the transactions being part of genuine grey market trading. In my judgment there was again evidence before the Tribunal which entitled it to reach that conclusion even disregarding Officer Stone's evidence.

32. *Due diligence*. ERR contends that the Tribunal failed to consider what information ERR would have learned if ERR had undertaken the due diligence checks listed by the Tribunal. Furthermore, ERR points out that it is clear that at least two of the checks would have left ERR none the wiser. Thus, had ERR obtained more up to date Redhill checks on Maximise, Exhibition and Regal, it would have found that they were all registered for VAT at that time. Similarly, the IMEI numbers would not have given ERR any reasons for suspicion. Counsel for ERR accepted that ERR's failure to conduct due diligence could nevertheless have been relevant to the issue of whether ERR had had actual knowledge that the deals were connected to fraud, but submitted that, once ERR was acquitted of actual knowledge, a mere failure to conduct due diligence did not establish that ERR should have known that the deals were connected to fraud unless it was shown that the information which

would have been revealed by proper due diligence would have led to that conclusion.

33. I accept this contention so far it goes. I do not accept, however, that it follows that the Tribunal was not entitled to take into account ERR's lack of due diligence as one factor among several others which supported the conclusion that ERR should have known that the transactions were connected to fraud. This is particularly so because, as I read the Tribunal's decision, the primary way in which the Tribunal regarded ERR's lack of due diligence as being relevant was as one factor which supported the conclusion that the profitability of the deals was "too good to be true": see [67] and [73].

34. In any event, even if the Tribunal was not entitled to take into account ERR's failure to carry out other due diligence checks, the Tribunal did explicitly consider what ERR would have discovered if it had obtained the Veracis reports in time: see [76]-[77]. I shall return to this point below.

35. *Lack of specificity*. ERR contends that a lack of specificity in the goods being traded was not indicative that the transactions were connected with fraud.

36. The Tribunal's findings of fact in this regard are set out at [53]:

> "There was no specification in Else's documentation of the goods being sold to its customers beyond the manufacturer and model number. In particular, there was no specification (in relation to mobile phones) of frequency, network configuration, warranty details, language types, batteries, rechargers or manual languages or (in relation to iPod Nanos) of colour, manual, boxing, chargers or warranty. AE's response when challenged on this point in cross-examination (in relation to mobile phones) was that Dubai (where Enastech was based) was a central trading hub for African and Asian countries and any modifications necessary would be done there at low cost."

37. It is fair to observe that the Tribunal did not explicitly state whether it accepted Anthony Else's explanation on this point or not. As I read the Tribunal's decision, however, it accepted his evidence as a true statement of what he believed, but nevertheless considered that this was one factor, among several others, which supported the conclusions that the deals were "too good to be true" and not explicable as being part of genuine grey market trading: see [68], [73] and [75]. In my judgment the Tribunal was entitled to do so.

38. *Two-pin chargers*. Again, ERR contends that this was not indicative that the transactions were connected with fraud. ERR says it was not uncommon for supplies of excess stock in Europe to be imported into the UK and sold to UK wholesalers. Even assuming that that is correct, however, it is not clear to me how ERR contends that it knew that at the time. Be that as it may, this was one factor, among several others, which the Tribunal relied on as supporting the conclusion that the deals were not explicable as being part of genuine grey

market trades: see [68] and [75]. In my judgment the Tribunal was entitled to do so.

39. *Five traders.* The Tribunal found at [48] that ERR had the means of knowing that there were at least five entities in the chain of supply (the original non-UK supplier, ERR's immediate UK supplier, ERR itself, ERR's non-UK customer and that non-UK customer's customer). The Tribunal went to say that "JE accepted that in hindsight such a chain would not have any commercial rationale". ERR disputes that Jason Else did accept this. I will assume that ERR is right about that.

40. More importantly, ERR again contends that this was not indicative that the transactions were connected with fraud. ERR says that there could have been five traders in the chain without there being fraud. I am willing to accept that that was a theoretical possibility. But in my judgment that does not mean that the Tribunal was not entitled to rely upon this factor as one among several which supported its conclusion at [75] that the deals were not explicable as being part of genuine grey market trading.

41. *Release before payment.* Again, ERR contends that this was not indicative that the transactions were connected with fraud. Again, I consider that the Tribunal was entitled to rely upon it as one factor among several which supported its conclusion that the deals were not explicable as being part of genuine grey market trading.

42. *Misunderstanding the danger*. ERR accepts that the Tribunal was entitled to conclude that ERR could have informed itself better as to the nature of MTIC fraud and that the Tribunal was entitled to treat ERR as if it had had that knowledge. ERR contends, however, even with such knowledge, the other factors relied upon by the Tribunal were not sufficient to establish that ERR should have been aware that the transactions were connected with fraud. But in my judgment the Tribunal was entitled to rely on ERR's misunderstanding of the danger as explaining why the Tribunal had concluded that ERR did not have actual knowledge that the transactions were connected with fraud when ERR should have known that fact.

43. *Veracis reports.* As the Tribunal found at [50], ERR obtained reports from Veracis "as a useful precaution" in the light of Public Notice 726 – in other words, because it was aware of the risk of MTIC fraud. Despite this, it obtained the reports after the event, when it was too late for them to be of any use. When obtained, the reports revealed the information I have summarised in paragraph 25(viii) of this judgment. As noted above, the Tribunal was entitled to proceed on the basis that this was information which was ascertainable by ERR at the time of entering into the transactions. ERR contends that it does not demonstrate that the transactions were connected with fraud. In my judgment, however, it was evidence which the Tribunal was entitled to rely on, in combination with other evidence, as showing that ERR should have known that the transactions were connected with fraud.

44. *Overall*. Standing back and looking at the Tribunal's decision overall, while I accept that some aspects of the Tribunal's reasoning are open to criticism, I

consider that the Tribunal's conclusion was one that was open to it on the evidence to which it referred in its decision. It is therefore not necessary for me to consider HMRC's contention that there was other evidence before the Tribunal, but which was not referred to in its decision, which supported that conclusion.

Conclusion

45. The appeal is dismissed.

MR JUSTICE ARNOLD

Release date: 10 January 2014