Value added tax – Input tax – Disallowance of input tax – Missing trader intra-Community fraud – Transactions connected with fraudulent evasion of value added tax – Trader denied entitlement to deduct input tax on basis of connection with fraudulent transactions – Tribunal finding that the only reasonable conclusion was that the trader knew or should have known it was that transactions were connected with fraud although 11 of 90 transactions not positively proved to be so connected – Tribunal finding denial of input tax permissible only to level of value added tax fraudulently evaded – Whether tribunal in error and comparator with indicia of legitimate trades necessary."

[2015] UKUT 0162 (TCC)
Case No: FT/108/2013

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 31 MARCH 2015

Before :

THE HON MRS JUSTICE ASPLIN DBE
UPPER TRIBUNAL JUDGE JOHN WALTERS

- -

Between :

S&I Electrical Plc	**Appellant**
- and -	
Commissioners for HM Revenue and Customs	**Respondent**

- -
- -

Paul Lasok QC and Frank Mitchell (instructed by **The Khan Partnership**)for the **Appellant**
Malcolm Davis-White QC and Aidan Robertson QC (instructed by **Howes Percival**) for the **Respondent**

Hearing dates: 27 and 28 January 2015

- -

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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THE HON MRS JUSTICE ASPLIN DBE
and
UPPER TRIBUNAL JUDGE JOHN WALTERS

Mrs Justice Asplin and Judge John Walters :

1. This is an appeal from a decision of the First-tier Tribunal Tax Chamber *(*the "FTT") released on 5 April 2013 ("the Second FTT Decision"). It is concerned with the consequences of "Missing Trader Intra-Community" ("MTIC") VAT fraud. The Second FTT Decision arose as a result of a remittal by the Upper Tribunal to the FTT of an issue arising from the FTT's original decision in this matter which was released on 18 May 2009 ("the First FTT Decision") which itself had been appealed to the Upper Tribunal by both parties. The Appellant, S&I Electronics plc ("S&I") has applied to the Court of Appeal for permission to appeal in respect of aspects of that Upper Tribunal's decision (the "Upper Tribunal Decision") other than the remittal. The question of whether permission should be granted has been adjourned pending the decision of this tribunal in relation to the treatment by the FTT of the issue remitted to it. The present appeal is without prejudice to S&I's position regarding the Upper Tribunal Decision.

2. As set out in the Upper Tribunal Decision, by 2006, the business of S&I was run through three divisions. The business of the third division consisted predominantly of the purchase and sale of mobile phones and in April 2006 had a turnover of £11.5m. Typically, S&I would buy phones from UK traders and sell them to traders established outside the UK as exports, or, in the case of sales to traders established in another Member State of the EU, dispatch sales. Between April and July 2006 S&I entered into 132 transactions for the sale of mobile phones, 99 of which were exports or dispatch sales. In 2007, Her Majesty's Revenue and Customs ("HMRC") denied S&I entitlement to deduct input tax in respect of 90 of the 99 exports or dispatch sales of mobile phones in April to July 2006 on the footing that the phones in question had previously been supplied by a person who had fraudulently evaded VAT (or, in one instance, by a "contra trader"[1]) and that S&I knew or ought to have known that the transactions *prima facie* giving rise to the entitlement to deduct input tax were connected with VAT fraud. The sums disallowed amounted to approximately £4.3m.

3. The Appellant appealed to the FTT against those decisions and in the First FTT Decision, after a fourteen day hearing, the FTT concluded that in 79 of the 90 transactions there was a connection to the fraudulent evasion of VAT in the sense that both the connection to a defaulter and that defaulter's fraudulent default was proved. In relation to the remaining 11 transactions, the FTT found that HMRC had not proved either that there was a fraudulent default or the chain of transactions connecting S&I to the alleged fraud or both. It did not find, however, that in fact there was no such connection or fraudulent default. The conclusions were reached after detailed consideration of each of the transactions the basis of which was set out in three appendices to the First FTT Decision. That consideration did not take into account the surrounding matters which the FTT considered when determining the state of S&I's knowledge in relation to the transactions.

[1] A trader (SPC Direct) whom HMRC alleged had taken credit for input tax on its purchase of goods, which had previously been supplied by a person who had fraudulently evaded VAT (CT Co), against that trader's (SPC Direct's, i.e. the contra-trader's) liability for output VAT on the supply of other goods by it, which were supplied down a chain of transactions to S&I and in relation to which S&I claimed to deduct input VAT.

4. In that regard, the FTT also decided that S&I had not known that the 79 transactions referred to were connected to fraud but that it should have known of the connection. It did so having applied the test described by Judge Hellier in the Second FTT Decision at [3] as follows:

> "whether a reasonable man with ordinary competence in the position of S&I, and knowing what S&I knew, (a) would have taken any additional steps and (b) would have come to the conclusion, on the basis of what he knew and had found out, that it was *more likely than not* that the transaction was connected to fraud."

The disallowance was upheld to a considerable extent.

5. As the Upper Tribunal pointed out in the Upper Tribunal Decision, which was released on 12 March 2012, the First FTT Decision was warranted by the authorities as they stood at the time. However, the decision in *Mobilx Ltd (in administration) v Revenue and Customs Commissioners and other actions* [2012] STC 1620 ("*Mobilx*") in the Court of Appeal established that the test which had been applied was wrong. As the Upper Tribunal set out at [44] of the Upper Tribunal Decision, the Court of Appeal had held in *Mobilx* "that the right to deduct input tax would be lost if a trader knew or should have known that he *was* taking part in a transaction connected with fraudulent evasion of VAT but not if he merely knew or should have known that the transaction was *more likely than not* to be so connected". (original emphasis)

6. At [46] of the Upper Tribunal Decision, the Upper Tribunal formulated the relevant question as:

> "Can it then be said in the present case that the FTT's findings mean that "the true and only reasonable conclusion is that [S&I] knew or should have known that [its] transactions were connected with fraud or that there was no other reasonable possibility other than that they were connected . . . with fraud?"

It went on to conclude that the First FTT Decision did not entitle the Upper Tribunal to infer that the question posed was answered in the affirmative nor to justify deciding the opposite. As a result the issue was remitted to the FTT to apply the *Mobilx* test. The Upper Tribunal left open the question of whether there should be further evidence before the FTT in relation to the remitted issue. Subsequently, the parties agreed directions for the hearing of the remitted issue by the FTT, having agreed that no further evidence should be admitted and that the FTT should consider the matter only on the basis of the evidence deployed before it when considering the case in 2008.

The Second FTT Decision

7. At [4] of the Second FTT Decision Judge Hellier who sat alone, Mr Shaw having since retired, set out the passage from the judgment of Moses LJ in *Mobilx* in which the correct test was promulgated as follows:

> "4. ... After our decision was released, and before the hearing before the Upper Tribunal, the Court of Appeal decided the appeal in *Mobilx Ltd (in administration) v Revenue and Customs Commissioners* and other actions [2010] STC 1436. The test of knowledge we had applied was there held to have been wrong. Moses LJ said:
>
> > "[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 surrounded 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 transactions 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 position to be derived from *Kittel* does not extend to circumstances in which the 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.""

Judge Hellier went on at [5] of the Second FTT Decision to state that the Upper Tribunal had pointed out the correct test to be applied and quoted paragraph [46] of the Upper Tribunal Decision, to which we have referred. Lastly, in this regard, at [7] Judge Hellier stated succinctly, "Thus I have to decide whether on the evidence before the tribunal S&I should have known that its transactions were connected to fraud." Despite the concise manner in which the question is set out at [7], there is no dispute that Judge Hellier considered the entirety of the matter remitted to him as described in paragraph [46] of the Upper Tribunal Decision and set out in the extract from the judgment of Moses LJ.

8. At [48] of the Second FTT Decision, the FTT stated that it considered that the determination of whether S&I should have known of the fraud (referred to as the second limb of the *Kittel* test) required the application of "an objective test, and it must be made by reference to objective factors." When determining how one decides whether the objective factors lead to a conclusion that the person should have known of the fraud, Judge Hellier concluded:

> "[48] In relation to Mr. Patchett-Joyce's second criticism, I believe it evaporates on further consideration. The second limb of the *Kittel* test requires the tribunal to determine whether a taxpayer

> should have known of the fraud. That must be an objective test, and it must be made by reference to objective factors. But, having set out the objective factors, how is one to determine whether they lead to a conclusion that a person should have known? The process of reasoning from fact to conclusion is a human one and it requires a human to do it. That raises the questions of what sort of human: a child, an overzealous customs officer, or a reasonable man, and of what degree of knowledge to attribute to him. (Whatever else, it seems to me that it cannot be a question of what the appellant actually concluded because that is the same as knowledge.) The only human entity in a position to conduct this exercise is the tribunal, and to my mind use by the tribunal of the "reasonable businessman" in its decision-making is merely an attempt to describe the mindset it adopted in taking that decision. By using "reasonable" it indicates that it did not attempt to clothe itself in the mindset of a child, a paranoid customs officer or habitual VAT villain, but retained its own (presumed reasonable) mindset; and by the use of "businessman" described itself as having some knowledge of commercial transactions. It is thus a description of the deducting mindset of the tribunal in approaching the facts (and a denial of any pretence of being something different) rather than the creation of a new test. Thus in this decision it would make no difference if I replaced "the reasonable businessman" with "I"."

9. The issue which is at the heart of this appeal is considered at [49] and [50] in the following way:

> "(5) Can it be found that a trader should have known of fraud when it is not proved that fraud does not exist in the chain or where it is shown that there is no fraud?
>
> [49] I have noted above that we found that it was not proved that in eleven of the 90 deals there was a connection to a fraud. The question arises in the circumstances of those eleven deals as to whether it is logically possible to find at the same time: both that the taxpayer should have known that they were connected to fraud, and that is not proved that they were. That question is acute because the objective factors which convinced us that a reasonable business man would have concluded that it was more likely than not that the transactions were connected to fraud were the same in every case. There was no difference between those factors in relation to a deal not shown to be linked to fraud and one which was.
>
> [50] This question is more disturbing when one is applying the test in Mobilx. Applying that test, the should have known limb is satisfied if the only reasonable explanation of the facts is that the taxpayer's transactions are connected with fraud: but if the only reasonable explanation of what was known to S&I was fraud, how can the tribunal find that it was not proved that they were connected with fraud — particularly where the tribunal will have

had details of the sales and purchases in the chain of supply which were not available to S&I?"

The FTT went on to find at [51] to [56]

> "[51] Put another way, does our original finding that some deals were not proved to be connected to fraud necessarily entail a conclusion, not only that S&I could not have concluded that the only reasonable explanation of the circumstances of those eleven deals was fraud, but also, because the information available to S & I in all the other cases was the same, that in no case could S & I have so concluded?
>
> [52] Mr. Davis-White answered this thus. He gave the example of a person so severely injured in a car crash that a bystander might say that the only reasonable expectation was that he would die, but unbeknown to him a skilled surgeon was on hand who actually saves him. The "only reasonable explanation" allows for the possibility of another explanation. Further Mr. Davies-White says that the conundrum disappears when the possibility of the trader taking further steps (making further enquiries) is considered.
>
> [53] Mr Davis-White also points to para [59] of Moses LJ's judgement in *Mobilx* where he says:
>
> > "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 transactions was [*sic*] connected with fraudulent evasion of VAT then he should have known of that fact."
>
> [54] Mr Davis-White says that the italicised words show that Moses LJ recognised that one could reach a conclusion that the only reasonable explanation of a transaction was connected to fraud when the transaction was not in fact proved to have been so connected.
>
> [55] I am generally with Mr. Davis-White on these points. The only reasonable explanation does not preclude the existence of unreasonable but possible explanations. However in the eleven deals in which we found that the connection was on balance not proven, a conclusion that the only reasonable explanation was connection to fraud might call into question our finding that the deals were not proven to be connected. That finding in each case was reached on the evidence of (i) the chain of supply to S&I and (ii) the alleged fraud of a person in that chain: but our decision betrays that we did not consider the factors relevant to S&I's knowledge in reaching our conclusions as to whether those deals were connected with fraud. That may be therefore a fault in our decision as regards those details, but it is not one which may be corrected by me in this decision. But because we concentrated on

> the direct evidence in relation to the fraud and the chain of supply rather than the wider circumstances, and because we did not find that there was *not* fraud, it leaves open to me to find that the only reasonable explanation of the circumstances of the deals in these cases was that they were linked to fraud.
>
> [56] Had we found that it was proved that certain deals were not connected to fraud, in my view, one could only then find that the only reasonable explanation for the other deals was connection to fraud if either the circumstances of those deals were outside the reasonably possible or if there was evidence distinguishing their circumstances from the others."

10. The question of whether the only reasonable explanation of the deals was that they were connected with fraud and whether S&I should have known that that was the case was considered at paragraphs [69] – [83] of the Second FTT Decision. The FTT relied upon a number of findings of fact made in the First FTT Decision and dealt with the matter under five headings, two of which were numbered (iv). They became known during the hearing as the "five indicia". The first was "(i) A chain of transactions before S&I" as a result of which the FTT concluded at [70] "It was clear to me that S&I was aware that contemporaneously with its purchase and sale there was a series of virtually contemporaneous purchase and sales by UK traders." The second heading was "(ii) Margins" and the conclusion at [71] was that S&I were aware that it was a feature of the market that the margin per phone made by a UK to UK trader in the chains of transactions was fairly standard and less than that made by exporters. The third heading was "(iii) Non UK Specification Phones". At [72] the FTT found that the phones S&I dealt in "were mostly of Central European specification with plugs not intended for the UK Market." The FTT went on at [73] – [76] as follows:

> "73. The only possible explanations that I can see for this are: (i) that the phones had been converted in the UK (for why else were they in the UK) to non UK specification prior to the start of the chain of contemporaneous transactions; (ii) they were being bought and sold as commodities in a price arbitrage market in which their precise specification did not matter; and (iii) they were in the UK so that they could be exported.
>
> 74. As regards (i) it seems to me that it is possible that UK specification telephones could be acquired in the UK and converted here to EU specification with the intention of being sold on into the EU. It does not however seem reasonable to suppose that such conversions would have been done on a speculative basis without the guarantee of a certain customer on the kind of scale which S&I's transactions involved: whilst it seems perfectly reasonable that a single consignment of phones might have been converted for a sale which failed and which were then offered for sale more generally (or that a single consignment of phones with European specification might have been brought into the UK with the object of changing them ready for sale in the UK market, and that perhaps circumstances changed and the holder received an offer he could

> not refuse from a member of S&I's chain so that they were then exported to their "home" market by S&I) I can see no reasonable explanation of how this could happen in such a large number of cases. I conclude that (i) is not a reasonable explanation.
>
> 75. So far as (ii) is concerned I can understand phones being dealt with as commodities so that traders in the UK might buy and sell them even though they were not configured for the UK market. But that does not explain why all the consignments of phones were in the UK: such trades would not require the movement of the phones across frontiers. Neither their export by S&I nor their presence in the UK while being bought and sold by members of the chain are consistent with that explanation. Indeed any transport is inconsistent with such trade because it increases cost and diminishes margins.
>
> 76. I conclude that the only reasonable explanation for the presence of these phones in the UK was that they were brought into the UK for the purpose being exported after having been bought and sold by a chain of UK dealers who did not hold stock."

11. The fourth heading in relation to the findings was "(iv) Details on invoices etc". The FTT found that the invoices and purchase orders in relation to the deals contained very little detailed description of the phones. The FTT went on at [78] – [81] to conclude that this factor "further confirms that the only reasonable explanation of the trade was connection to some scheme involving their trading and export" having rejected the alternative conclusion that these were arbitrage transactions.

12. The fifth heading also numbered (iv) was "Knowledge of fraud". The findings under this head were as follows:

> "82. Knowledge that the phones were being traded in the UK for the purpose only of exporting them has only one reasonable explanation namely that they were connected with VAT fraud.
>
> 83. S&I knew that there was significant VAT fraud in the market in which it operated. It knew that some of its transactions had been connected to such fraud. It also knew the nature of the fraud. So it knew that it involved the default by one member of a supply chain in the payment of VAT and the export of phones. It must have known that the only reasonable explanation of trade in the UK for the purpose of exporting was VAT fraud.
>
> 84. I conclude that S&I should have known that the only reasonable explanation of the deals was that they were connected to VAT fraud. I reach this conclusion without considering what additional information S&I could have obtained."

13. It is not in dispute that the conclusion at [84] was reached on the basis of the matters considered at [69] to [83] and as Judge Hellier stated expressly was made

without reference to any additional information which might have been gleaned by S&I had it made further investigations.

14. Furthermore, it is not in dispute that the additional conclusion at [85] is in the alternative to that at [84] and proceeds upon the basis that the further investigations referred to at [215] of the First FTT Decision should have been carried out and, had they been, they would have revealed that there was a connection to fraud. The alternative conclusion at [85] is in the following form:

> "85. However even if there were a possible explanation of the other circumstances of each of its deals other than connection to VAT fraud, it is clear to me that the concerns detailed in our decision would have excited such serious concern that they were linked to fraud that the only reasonable response would have been to make the further investigations described in paragraph 215 of our decision, and that those investigations would have revealed that there was a connection to fraud. That is because the information received would have only one reasonable explanation, namely fraud. Thus if as I believe to be the case, I am entitled to consider what S&I would have found out if it had taken the steps a reasonable businessman in its position would have taken, it would have concluded that its deals were connected to fraud."

15. The FTT went on to consider the effect of the different test applied in the First FTT Decision at [86] in the following way:

> "Passages in our decision
>
> 86. We addressed our decision to the test of likelihood of connection, and provided our conclusions on the basis of the requirement that the test was met if it was more likely than not. But there is in my view a link between what may be called a risk based approach and the "no other reasonable explanation" approach. It is this: an explanation that is highly unlikely is not a reasonable explanation; one that is likely is reasonable. If the delivery van does not arrive there may be a number of possible explanations. One is that the driver has been eaten by a lion, another that she is stuck in traffic. The absence of a zoo, a circus or reports of an escaped lion in the vicinity makes the first of these an unlikely and therefore unreasonable explanation; the presence of a nearby normally congested road makes the second a not unlikely and a reasonable explanation; if in the circumstances that reason is more likely than not it must logically be the most reasonable explanation. On that basis one might characterise our decision as being that the most reasonable explanation was connection to fraud."

16. Finally, the FTT concluded at [92] of the Second FTT Decision that S&I "should have known that its deals were connected to fraud because that is the only reasonable explanation of the circumstances of those deals".

Permission to Appeal and an Explanation in relation to the Second FTT Decision

17. Permission to appeal in relation to the Second FTT Decision on one ground which has been referred to as Ground 1, was granted to S&I by the FTT in a decision released on 26 June 2013 (the "FTT Permission to Appeal Decision"), as clarified by a "Note" dated 14 August 2013. Permission to appeal in respect of the grounds for which permission was refused (and which are now referred to as Grounds 2 – 5) was subsequently granted by the Upper Tribunal.

18. In the FTT Permission to Appeal Decision, Judge Hellier indicated his concern that some of the grounds of appeal reflected a misreading of the Second FTT Decision and explained the structure of the Second FTT Decision. He stated (at paragraph 4(2)) that "from paragraphs 69 to 85 the tribunal addressed the question remitted to it by the Upper Tribunal – whether using the *Mobilx* test, the only reasonable explanation of S&I's deals was that they were connected to fraud, and if so whether S&I should have known that they were." He went on to set out paragraph [84] of the Second FTT Decision and to comment in the following way:

> '"I conclude that S&I should have known that the only reasonable explanation of the deals was that they were connected to VAT fraud. I reach this conclusion without considering what additional information S&I could have obtained."
>
> The second sentence in this paragraph relates to a discussion in both the First decision and Second Decision as to whether, had S&I made further enquiries – such enquiries which the tribunal thought a reasonable businessman would have made – it would have discovered further information which would have made it certain that there was a connection to fraud.
>
> (3) From paragraphs 86 to 90 the tribunal addressed whether any aspects of the Second Decision were inconsistent of [*sic*] with the First Decision.'

He went on at paragraphs 7 and 8 of the FTT Permission to Appeal Decision as follows:

> "7. . . . The tribunal's conclusion at [84] is not predicated on any test of what a reasonable businessman would have done. The conclusion is framed in terms that a specified list of factors had only one reasonable explanation. The reasoning in paragraphs 68 to 83 owes nothing to what a reasonable businessman would or would not done [*sic*]. The consideration in the Second Decision of what a reasonable businessman would have done and found out, is only as an alternative if the tribunal's main conclusion is wrong.
>
> 8. When the tribunal discussed Mr Patchett-Joyce's submission in relation to the use of the notional reasonable businessman in paragraph [48] the Second Decision it concluded that the words were simply a description of the mindset of the tribunal in approaching the question of what S&I had the means of knowing, rather than any sort of new

> test. That is not the same therefore as using the reasonable businessman test to determine on the basis of the facts known to S&I what was the only reasonable explanation of those facts. The tribunal did not refer to a reasonable businessman in making its decision in [84]: it was made solely on the basis of what was a reasonable explanation. . . ."

Test to be applied in this appeal

19. Before turning to the Grounds of Appeal, it is important to bear in mind that the jurisdiction of the Upper Tribunal is derived from section 11(1) of the Tribunals, Courts and Enforcement Act 2007 which provides for a right of appeal from the FTT only on points of law. It is accepted that findings of fact, whether primary facts or factual inferences can only be disputed on appeal on *Edwards v Bairstow* grounds, that the finding or inference in question is irrational.

20. Further, before turning to the specific grounds of appeal, we should mention that Mr Lasok referred us to *Bonik EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto'* [2013] STC 733 a case concerned with the refusal of a right of deduction of VAT in Bulgaria. In particular he referred to [37] and [39] to [43] which are as follows:

> "37. That is the position where a tax fraud is committed by the taxable person himself. In such a case, the objective criteria which form the basis of the concepts of 'supply of goods or services effected by a taxable person acting as such' and 'economic activity' are not met (see *Halifax*, paras 58 and 59, and *Kittel and Recolta Recycling*, para 53).
>
> …
>
> 39. By the same token, a taxable person who knew, or should have known, that, by his purchase, he was taking part in a transaction connected with VAT fraud must, for the purposes of Directive 2006/112, be regarded as a participant in that fraud, whether or not he profits from the resale of the goods or the use of the services in the context of the taxable transactions subsequently carried out by him (see, to that effect, *Kittel and Recolta Recycling*, para 56, and *Mahagében and Dávid*, para 46).
>
> 40. It follows that a taxable person cannot be refused the right of deduction unless it is established on the basis of objective factors that that taxable person - to whom the supply of goods or services, on the basis of which the right of deduction is claimed, was made - knew or should have known that through the acquisition of those goods or services, he was participating in a transaction connected with VAT fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply of those goods or services (see, to that effect, *Kittel* and *Recolta Recycling*, paras 56 to 61, and *Mahagében and Dávid*, para 45).

> 41. On the other hand, it is incompatible with the rules governing the right of deduction under Directive 2006/112 to impose a penalty, in the form of refusal of that right, on a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud committed by the supplier or that another transaction forming part of the chain of supply, downstream or upstream of the transaction carried out by the taxable person, was vitiated by VAT fraud (see, to that effect, *Optigen*, paras 52 and 55; *Kittel and Recolta Recycling*, paras 45, 46 and 60; and *Mahagében and Dávid*, para 47).
>
> 42. The establishment of a system of strict liability would go beyond what is necessary to preserve the public exchequer's rights (see *Mahagében and Dávid*, para 48).
>
> 43. Consequently, since the refusal of the right of deduction is an exception to the application of the fundamental principle constituted by that right it is incumbent upon the competent tax authorities to establish, to the requisite legal standard the objective evidence needed to substantiate the conclusion that the taxable person knew, or should have known that the transaction relied on as a basis for the right of deduction was connected with fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply (see *Mahagében and Dávid*, para 49)."

21. Mr Lasok emphasises that the burden is upon HMRC to establish "to the requisite legal standard" the objective evidence needed to substantiate the conclusion that the taxable person knew or should have known of the connection with fraud. In this regard, he also referred us to *Unipetrol a.s. v European Commission* (Case T-45/07) for the proposition that the requisite standard of proof was "proof that is sufficient in law." However, he accepted that the standard of proof applied is neither a ground of appeal from the Second FTT Decision nor is it likely in practice to have been of significance in the light of the high threshold inherent in the *Kittel* test itself.

GROUND 1: The significance of fraud not being proven in several of the impugned transactions

22. Mr Lasok submits that when answering the question, what is or are the only reasonable explanation(s) for a particular transaction, it is necessary to inform oneself about the particularities of the trade in question in order to have some proper basis upon which to distinguish a transaction whose only reasonable explanation is a connection with fraud from others. In other words, he says that the question cannot be answered in the abstract and it is necessary to have a comparator with the indicia of a legitimate transaction against which to compare the others. He says that this is all the more important where, as is common ground, there has been a legitimate trade in mobile phones before, during and after the period to which the HMRC decisions refusing the Appellant's input tax deduction claims relate.

23. Accordingly, he submits that it was crucial for the FTT to have identified externally observable features of, or circumstances surrounding, the deals connected with fraud ('objective factors'), that were known to the Appellant that differentiated those deals from transactions unconnected with fraud. He says that this was necessary because features or circumstances shared by transactions unconnected with fraud cannot be relied upon as showing that the only reasonable explanation for a particular transaction is that it is connected with fraud. He says that no such exercise was undertaken whether by HMRC or the FTT and that in the Second FTT Decision, the FTT noted at [49] that:

> "the objective factors which convinced us that a reasonable business man would have concluded that it was more likely than not that the transactions were connected to fraud were the same in every case. There was no difference between those factors in relation to a deal not shown to be linked to fraud and one which was."

As a result, Mr Lasok submits that the FTT had no evidential basis on which it could lawfully find in favour of HMRC, whether under its reason in [84] or [85] (which he accepts are logically independent), and was wrong to have done so.

24. Furthermore, Mr Lasok criticises the FTT's conclusion at [55] of the Second FTT Decision that "the "only reasonable explanation' allows for the possibility of another explanation." He asks whether the test was actually satisfied on the basis of the evidence, given that there was a legitimate trade in 2006, that there was no evidence of the norm and all of the 90 trades under consideration, both the 79 in which a connection to fraud was proved and the 11 in which it was not, had the same features. Mr Lasok says that the fact that HMRC failed the "balance of probabilities" test means necessarily that they could not succeed on the "only reasonable explanation" test.

25. Mr Lasok goes on to submit that in relation to those transactions in relation to which there was no evidence of a connection to fraud, the allegation of a connection with fraud is nothing more than a speculative and unfounded assertion, that precludes any finding that the *only* reasonable explanation for those transactions is a connection with fraud. If the two groups of transactions are indistinguishable, it cannot be said that, viewed objectively, the *only* reasonable explanation for the second group is that they are connected to fraud.

26. Mr Lasok also criticises the reasoning in the remainder of [55] to the effect that because in the First FTT Decision the FTT concentrated on the chain of supply to S&I and the alleged fraud of a person in that chain but did not consider the factors relevant to S&I's knowledge in reaching its conclusions as to whether the deals were connected with fraud, and because it did not actually find an absence of fraud in 11 of the transactions, it was open to the FTT to find that the only reasonable explanation of the circumstances of the deals in the 79 cases was that they were linked to fraud.

27. He says that the 'five indicia' on which the FTT relied when concluding that the Appellant should have known that the only reasonable explanation of the deals was a connection with fraud set out and considered at [69] - [83] of the Second

FTT Decision were capable of producing "false positives" in that those criteria were held to have been fulfilled in circumstances where fraud could not be proven on a balance of probabilities and in circumstances where there was no evidence at all of a connection with fraud and (in at least one instance - Deal 8, which was the chain leading from the contra-trader to S&I) where the transaction chain was positively accepted to be free of fraud.

28. In fact, Mr Lasok took us to the details of the various trades set out in the appendices to the First FTT Decision and pointed out that the 11 transactions in which fraud was not proved fell into a variety of categories. In some he says that the details reveal a lack of the relevant documentation, whereas in others there was no evidence at all and Mr Lasok describes HMRC's case as speculative. In the third group he says that there was either no allegation of fraud at all or positive evidence contrary to HMRC's conclusions. In particular, in this regard, he referred to deal 4 in which it was found that there was no evidential link to a fraudster, deal 8 which was a contra-trade, in which there was no evidence that S&I knew of the fraud found to have been carried out by CT Co (the fraudster in the "dirty" chain leading to SPC Direct (the alleged contra-trader)) or of any fraudulent disguise of the connection with fraud carried out by SPC Direct in supplying goods into the "clean" chain leading to S&I, deal 14 in which there was no assertion of fraud by RK Bros, and deal 58 where it was not alleged that there was a defaulter at all. Mr Lasok points out that there is no analysis of this evidence in the Second FTT Decision and he submits that the FTT ignored the cases in which there was no fraud proved without any lawful basis for doing so.

29. He also points to the lack of evidence of the prevalence of fraud in the trade. Although there was evidence before the FTT on the first occasion in the form of a witness statement from a Mr Stone to the effect that in 2005/6 there was a turnover of around £21 billion in the trade as a whole which after the imposition of certain measures by HMRC was reduced to around £2.1 billion by the second half of 2006, it is not mentioned. In any event, Mr Lasok submits that given that £2.1 billion is hardly trivial, and that there was legitimate trade before during and after the transactions in question, it would not be unreasonable to conclude that the 11 transactions in which fraud was not proved fell within the trade which was legitimate and therefore, that it was unsafe of the FTT to rely upon the same 'five indicia' in the case of the 79 and the 11 without any reference to what may be the norm.

30. Mr Lasok says that this flaw infects both the conclusion at [84] and the alternative at [85] because on the evidence there was no differentiation between the indicia of legitimate and illegitimate trade which would have led either to the only reasonable explanation being a connection with fraud or which would have been such as to have excited such serious suspicion, that the only reasonable response thereto would have been to make further investigations.

31. In response, Mr Davis-White on behalf of HMRC says that, if Mr Lasok is right, HMRC would have first to prove fraud in all the deals in question and then in relation to all of the deals which S&I had ever carried out, prove which were connected with fraud and which were not, list all the features and state which were present only in the fraudulent trades and whether that was known to S&I or that S&I should have drawn the relevant conclusions. In fact, he says that when

applying Mr Lasok's 'reasonable businessman' test (to which we refer below), it would be necessary to carry out the analysis across the entire market. If the taxpayer knew about some factors in relation to one deal and others in another, it would never be possible to satisfy the test and that cannot be correct.

32. Mr Davis-White submits that although it is necessary for there to be a connection with fraud in order to deny the taxpayer input tax, it is nevertheless possible to satisfy the "only reasonable explanation" test in relation to the taxpayer's state of knowledge without an actual connection to fraud in every case. He says therefore, that although input tax cannot be denied in the case of the 11 transactions in which fraud was not proved, that does not prevent the FTT from concluding quite properly that at the time of the transactions in 2006, the only reasonable explanation test was satisfied, despite the fact that connection to fraud was established on different evidence at a later stage, in relation to only 79 transactions. He says that it is clear from the passage from the judgment of Moses LJ in *Mobilx* at [59] and [60] that such a position is possible and that the Court is looking at two different issues at two different times. He also emphasises that the FTT did not find that there was no connection with fraud in the 11 cases, merely that the connection was not proved.

33. He says that the same is true in relation to the decision of the FTT on the alternative ground at [85]. The fact that a connection to fraud may not be proved at a later date on different evidence does not undermine the conclusion reached on objective grounds that matters in question would have excited such serious concern that they were linked to fraud that the only reasonable response would have been to make further investigations and that those investigations would have revealed that there was a connection to fraud. He says that this is because the information received would have only one reasonable explanation, namely fraud.

Conclusion:

34. First, in this regard, we should make clear that we agree with Mr Davis-White that the question of whether the "only reasonable explanation" test is satisfied is to be answered at the time of the transactions in question and based upon the matters within the knowledge or which ought to have been within the knowledge of S&I at that time. This is clear from the extract from the judgment of Moses LJ in *Mobilx* to which we have referred. The decision as to whether in fact, there is a connection with fraud, is made at a different time and may be decided by reference to different evidence.

35. On that basis, we go on to examine the FTT's findings of fact as to what S&I knew or ought to have known at the time of the transactions in question (April to July 2006).

36. The FTT found that S&I did not know that its deals in the relevant period were connected to fraud (paragraph [205] of the First FTT Decision). It also found that S&I was aware that there was serious fraud in the grey mobile phone market, that S&I's due diligence procedures had not protected it from acquiring mobile phones connected to fraud, and that S&I did not take the actions "which would have been taken by a reasonable businessman (or which were reasonable and proportionate) to ensure that its future transactions would not be connected with fraud"

(paragraph [206] of the First FTT Decision). These we regard as findings of fact which were open to the FTT to find and which cannot be challenged.

37. The FTT further stated that such actions would have included (i) requiring S&I's suppliers to certify that their suppliers had provided evidence of their existence, VAT registration and ability to pay their VAT and that they were making similar requirements of their suppliers in turn (and so on); (ii) ceasing to trade with any supplier until adequate believable certification had been received; and (iii) requiring that suppliers identified in letters from HMRC (the "Fraudulent Chain Letters") dated 28 February 2006 and 12 April 2006, as featuring in chains found to have been traced back to defaulting traders, and their suppliers and remoter suppliers down the chain also, should submit to an independent audit of their certification before and in relation to any further transaction to be undertaken with them (such auditor being mandated not to reveal the identity of the remoter suppliers) (paragraph [207] of the First FTT Decision). These we do not regard as findings of fact at all, but as part of the FTT's reasoning, leading to its conclusion that a reasonable businessman in S&I's position would have discovered 'the fraud in relation to the transactions at issue with [the suppliers identified in the Fraudulent Chain Letters]' or that such a reasonable businessman would have reached the conclusion that it was likely that there was fraud in the chain (paragraph 211 of the First FTT Decision).

38. The FTT found that the principal concerns of Mr Ashraf Mohammed, a director of and shareholder in S&I, the uncle of Mr Tariq Mohammed, another director and manager of S&I, were related to his business relationships and with satisfying the documentary requirements for the repayment of S&I's VAT claim, and that he did not direct his mind seriously to the question of whether or not it was likely that his purchases were connected with fraud (paragraph [203] of the First FTT Decision). These we also regard as findings of fact which were open to the FTT to find and which cannot be challenged.

39. The FTT also found the facts summarised in the "five indicia" which we have already mentioned. That these were also findings which were open to the FTT to find and which cannot be challenged is, we consider, clear from: paragraph [70] of the Second FTT Decision (a chain of transactions before S&I) when read with paragraphs [213 (vi)(a)] and [109 (i)] of the First FTT Decision; paragraph [71] of the Second FTT Decision (margins) when read with paragraphs [213 (vi)(b)] and [109(ii)] of the First FTT Decision; paragraphs [72] to [76] of the Second FTT Decision (non-UK specification phones); paragraphs [78] to [81] of the Second FTT Decision (details on invoices, etc.); and paragraphs [82] and [83] of the Second FTT Decision (knowledge of fraud).

40. It seems to us that, clearly, on these findings of fact, S&I ought to have known that *a* reasonable explanation for the 79 transactions, where a connection to the fraudulent evasion of VAT was found, was that they were connected with fraud.

41. The crucial question is whether the FTT's conclusion that that was *the only* reasonable explanation was erroneous in point of law.

42. In his argument on Ground 1, Mr Lasok (as we have said) emphasised that the context of there being legitimate trades at the relevant time in the grey mobile

phone market (and of connection with fraud not being proved in the case of 11 of S&I's disputed transactions – and there being a further 9 exports or dispatch sales in the period which were not challenged by HMRC) required a comparison by reference to objective factors (cf. *Kittel* at [61]) to legitimate trades, in order to reveal that the connection to fraudulent evasion of VAT was the only reasonable explanation for the 79 transactions where a connection to fraud was found.

43. As we have already said, the FTT did not find that the 11 transactions were not connected to fraudulent evasion of VAT – merely that no such connection had been proved by HMRC. As to the further 9 exports or dispatch sales we know nothing, one way or the other, about whether or not they were connected to fraud. Indeed, and this we regard as an important point, there is no finding, or evidence, that *any* of S&I's transactions were *not* connected to fraud. In those circumstances, any presumption that they were not so affected would, we consider, be rebutted by the FTT's finding that 79 out of the 90 transactions examined were connected to fraud – the FTT expressed its conclusion on the remaining 11 transactions, that in those cases a connection to fraud was 'on balance not proven' (paragraph [55] of the Second FTT Decision).

44. That being the case, the observation in the Second FTT Decision at paragraph [49] that there was no difference between the objective factors in relation to a deal not shown to be linked to fraud and one which was shown to be linked to fraud is not significant. It was made in a context in which there were no deals which were shown positively *not* to be linked to fraud.

45. The FTT itself recognized that it did not consider the factors relevant to S&I's knowledge in reaching its conclusions on whether or not the deals were connected with fraud (paragraph [55] of the Second FTT Decision). Thus the conclusion that no connection with fraud had been proved by HMRC in relation to the 11 transactions took no account of objective factors relevant to the question of whether or not the only reasonable explanation for those transactions, at the time they took place, was that they were connected to fraud.

46. We consider that such objective factors (summarised by the FTT in the "five indicia" – see [10] above) amply justify a conclusion that the only reasonable explanation for the 79 transactions which were found to have been connected to fraud was that they were so connected and that S&I ought to have known of that fact. It is no bar to such a conclusion that there were other transactions in which fraud was not proved or that it is acknowledged that there were in the grey mobile phone market generally some legitimate trades. Evidence in relation to them would in all likelihood have exhibited different objective factors to those exhibited by the 90 transactions of S&I which were in issue, for example, in relation to the first four of the "five indicia": short chains, variable margins, UK specification phones, fully detailed invoices. But this is by the way. It is not required of HMRC in cases such as this that they should lead evidence of the way legitimate trade in the grey market is conducted for the purpose only of showing by comparison that the deals in issue in an appeal display different objective factors. What is required is that the Tribunal should be satisfied by reference to objective factors established by the evidence (1) that, at the time the transactions took place, S&I should have known that the only reasonable explanation for them was a connection with fraud, and (2) that they were so connected. The FTT was so

satisfied and we consider that no error of law is discernible in their decision on this point. We therefore reject S&I's first ground of appeal.

GROUNDS 2 and 3: The Reasonable Businessman Test and its application

47. In this regard, Mr Lasok submits that if and to the extent that the FTT did not apply the 'reasonable businessman' test when determining whether the 'only reasonable explanation' test had been satisfied, it was an error of law and was neither reasonable nor lawful. He says that in reaching the conclusion set out in [84] of the Second FTT Decision, the FTT seems to have or says that it adopted a different approach which is not explained but seems to have been entirely abstract and divorced from any understanding of the commercial context. In fact, he goes further and says that paragraph 8 of the FTT Permission to Appeal Decision which is set out at paragraph 18 above, makes clear that the "reasonable businessman test" was not applied.

48. In essence, this Ground asserts that the FTT did not apply the correct test in relation to the "should have known" limb of *Kittel*, which was to determine 'what a reasonable businessman with ordinary competence, knowing what [S&I] knew, would have concluded … at the time [S&I] entered into the transactions in question' (see: paragraph 23 of the Application for Permission to Appeal to this Tribunal). Instead, S&I submits, by reference to paragraph [48] of the Second FTT Decision, that the FTT substituted its own (subjective) view of what it would have done and what it would have known.

49. Mr Lasok says that this argument is open to him despite the fact that Mr Patchett-Joyce (who previously represented S&I) took a different stance before the FTT, arguing that the question should be determined solely by reference to objective factors without reference to the concept of the reasonable businessman. Mr Lasok says that the Appellant has always submitted that it is necessary to apply an objective approach and that in any event, even if a party submits before the FTT that the correct legal test is "X" but the FTT finds that it is "Y", the appellant cannot be prevented from appealing on the basis that the FTT failed to apply "Y" properly or at all.

50. Further, Mr Lasok submits that if and to the extent that the FTT purported to apply the reasonable businessman test, it erred in its understanding of the test and therefore erred in law. Mr Lasok says that the 'only reasonable explanation' must be determined by looking at the facts from the perspective of a reasonable businessman conversant with particularities of the trade in question. In order to do so, he says that the tribunal needs evidence from which to identify the relevant features of the legitimate trade in question in order to be able to ask itself whether the suspect transactions have indicia other than the norm and what the reaction of a reasonable businessman would have been to them.

51. However, he says that the only explanation of the FTT's understanding of the reasonable businessman test appears in paragraph [48] of the Second FTT Decision at which the FTT concluded that reference to the 'reasonable businessman' could be replaced by a reference to the tribunal itself. He submits that as a result, the FTT erred in law because it should not have applied its own mindset but should have put itself into the position of a businessman carrying on

business in the trade in question and in order to do so it must look at contextual evidence relating to that trade.

52. Mr Lasok adds that there is no evidence that the FTT put itself in the position of a reasonable businessman conversant with the trading patterns of the legitimate mobile phone trading industry, nor could it have, because no evidence was proffered by HMRC (on whom the burden of proof lay) such as would have enabled it to do so, and the FTT seems to have disregarded the evidence given on behalf of S&I. Mr Lasok adds that evidence of those conversant with the industry was essential in order to justify, evidentially as opposed to speculatively, the reliance placed by the FTT on any or all of the 'five indicia' and the FTT's inferences (such as that in paragraph [73] of the Second FTT Decision).

53. In response, Mr Davis-White submits that the application of the 'reasonable businessman' test was not raised before the FTT on the first occasion nor before the Upper Tribunal and that if it had, it might have affected the evidence tendered before the FTT on the second occasion.

54. In correspondence with the Tribunal after the conclusion of the hearing, the parties debated whether the conclusions reached by the FTT at paragraph [215] of the First FTT Decision could be challenged at this point. The conclusions concerned were as follows:

> "[the FTT's opinion that] a reasonable businessman in [S&I's] circumstances would have insisted upon the source of each new transaction being chased down the chain by an independent third party (who undertook not to divulge details of the suppliers' identities) as a condition for the completion of the transaction (or perhaps S&I could have insisted upon being given adequately secured personal indemnities from the individuals in charge of its suppliers against the loss of the input tax at stake as a result of any (or such insistence on indemnity) of fraud in the chain [sic]). In each case where there was a fraudulent trader this would in our view have revealed the fraud."

55. The conclusions at paragraph [215] of the First FTT Decision were, of course, adumbrated by its conclusions at paragraph [207] of the First FTT Decision as to the steps which, in its view, a reasonable businessman would have taken in relation to suppliers identified in the Fraudulent Chain Letters and other suppliers.

56. The post-hearing debate focused on whether S&I had mounted an *Edwards v Bairstow* challenge to the FTT's findings in paragraph [215] of the First FTT Decision and whether, even if there had been such a challenge, it was right to allow S&I to take the point at this stage that "the FTT erred in law in placing reliance on its conclusion that S&I ought to have taken steps that were commercially fanciful and failed to explain why those (and, possibly, other undisclosed steps) would have resulted, at the time when S&I entered into its transactions, in discovering relevant connection with fraud" (see: paragraph 5 of the letter sent to this Tribunal by Howes Percival, acting for HMRC, dated 9 February 2015).

57. We dispose of this point by stating that in our view paragraph [215] of the First FTT Decision (like paragraph [207] of the First FTT Decision) does not contain findings of fact, which would be susceptible of appeal only on *Edwards v Bairstow* grounds, but is part of the FTT's reasoning as to why S&I should have known of the connection to fraud (see: paragraph [216] of the First FTT Decision). There is therefore no impediment to Mr Lasok's challenge in this appeal to the FTT's formulation and application of the 'reasonable businessman' test.

58. In any event, Mr Davis-White submits that it is clear from paragraph [48] of the Second FTT Decision that the 'reasonable businessman' test as properly understood was applied. In that regard, he referred to *Healthcare at Home Ltd v Common Services Agency* [2014] 4 All ER 210, a case concerning the equal treatment of tenderers for public contracts in relation to the provision of medical services to health authorities in Scotland. In particular, he referred to paragraphs [1] to [4] of the judgment of Lord Reed with whom the remainder of the Supreme Court agreed. The paragraphs are in the following form:

> '[1] The Clapham omnibus has many passengers. The most venerable is the reasonable man, who was born during the reign of Victoria but remains in vigorous health. Amongst the other passengers are the right-thinking member of society, familiar from the law of defamation, the officious bystander, the reasonable parent, the reasonable landlord, and the fair-minded and informed observer, all of whom have had season tickets for many years.
>
> [2] The horse-drawn bus between Knightsbridge and Clapham, which Lord Bowen is thought to have had in mind, was real enough. But its most famous passenger, and the others I have mentioned, are legal fictions. They belong to an intellectual tradition of defining a legal standard by reference to a hypothetical person, which stretches back to the creation by Roman jurists of the figure of the bonus paterfamilias. As Lord Radcliffe observed in *Davis Contractors Ltd v Fareham Urban DC* [1956] 2 All ER 145 and 160, [1956] AC 696 at 728:
>
> > 'the spokesman of the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is, and must be, the court itself.'
>
> [3] It follows from the nature of the reasonable man, as a means of describing a standard applied by the court, that it would [be] misconceived for a party to seek to lead evidence from actual passengers on the Clapham omnibus as to how they would have acted in a given situation or what they would have foreseen. Even if the party offered to prove that his witnesses were reasonable men, the evidence would be beside the point. The behaviour of the reasonable man is not established by the evidence of witnesses, but by the application of a legal standard by the court. The court may require to be informed by evidence of circumstances which bear on its application of the standard of the reasonable man in any particular case; but it is then for the court to determine the

> outcome, in those circumstances, of applying that impersonal standard.
>
> [4] In recent times, some additional passengers from the European Union have boarded the Clapham omnibus. This appeal is concerned with one of them: the reasonably well-informed and normally diligent tenderer.'

59. Mr Davis-White says that the reasoning at paragraph [48] of the Second FTT Decision is entirely consistent with Lord Reed's explanation of the standard of the reasonable man and the way in which it is applied. He points in particular to the fact that Lord Reed describes the standard being established by the application of a legal standard by the court and submits therefore that it is not subjective despite the FTT's suggestion that "the reasonable businessman could be replaced by "I". He also says that, as a result, the FTT applied the appropriate objective standard.

60. Although Mr Lasok submitted that the flavour of paragraph [48] of the Second FTT Decision (summarised by the final sentence: 'Thus in this decision it would make no difference if I replaced "the reasonable businessman" with "I".') was too subjective, his real quarrel (as we understand it) was not with the concept of reasonableness applied by the FTT but with its assumption of the knowledge of a businessman. He submitted that in order to form a view of what a reasonable businessman with ordinary competence, knowing what [S&I] knew, would have concluded at the time [S&I] entered into the transactions in question, i.e. to apply the correct test, the FTT required to have before it the necessary evidence of the context in relation to which the reasonable businessman would have acted. That inevitably required evidence to be led by HMRC as to the normal characteristics of legitimate trade in the grey mobile phone market – but no such evidence had been led.

61. Mr Lasok also submitted that the FTT's conclusion in paragraph [215] of the First FTT Decision as to what a reasonable businessman in S&I's circumstances would have insisted on, ran contrary to the interpretation of the *Kittel* principle by the CJEU in succeeding cases. He mentioned particularly *Stroy trans EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-642/11) where the Court of Justice ruled (at [52]), in relation to an allegation by national tax authorities that a transaction relied on by a trader as the basis for the right of deduction of input tax had not actually been carried out, that:

> 'it must be established, on the basis of objective factors and without requiring of the recipient of the invoice checks which are not his responsibility, that he knew or should have known that that transaction was connected with VAT fraud, a matter which it is for the referring court to determine.'

62. Mr Lasok's case, therefore, was that in order to apply the 'reasonable businessman' test correctly, the FTT required evidence, which it had not had, of the relevant commercial context, so that it could put itself in the position of a reasonable businessman faced with an abnormal transaction. Only then could the FTT safely decide what, if any, additional steps, being checks which were S&I's

responsibility, could be expected to be carried out by a reasonable businessman, and what the consequences of such steps would have been. He drew our attention to paragraph [220] of the First FTT Decision, where the FTT stated that:

> 'the steps we believe reasonable [including those suggested at paragraph [215]] were not suggested to S&I at the time, or put to Mr Ashraf or Tariq Mohammed at the hearing. Neither were they suggested by [HMRC]. We cannot see that that makes any difference.'

63. Mr Lasok submitted that the two additional steps referred to by the FTT at paragraph [215] of the First FTT Decision were suggested in the absence of any basis in evidence of either their practicality or that the consequence of taking them as stated at paragraph [85] of the Second FTT Decision, was that 'those investigations would have revealed that there was a connection to fraud'. To emphasise this latter point, Mr Lasok reminded us that HMRC's own investigation capability (despite their statutory powers) was limited.

64. In our judgment (as we indicated in relation to Ground 1) Mr Lasok goes too far in his submission that the FTT could not determine whether S&I should have known of the connection with fraud of the 79 transactions without evidence of the normal characteristics of legitimate trade in the grey mobile phone market. In accordance with the extract from Lord Reed's judgment in *Healthcare at Home Ltd v Common Services Agency*, the FTT's task was to apply the impersonal standard of the reasonable businessman to the facts which it found, on the basis of the evidence which it heard, as to the circumstances in which S&I carried out the transactions in issue. Would the reasonable businessman have concluded that S&I ought to have known that the only reasonable explanation for the transactions was that they were connected with fraud?

65. It is true that the FTT was required to invest the reasonable man for these purposes with the characteristic of being a reasonable businessman with ordinary competence, but in our judgment a reasonable businessman with ordinary competence is not so egregious or specialist a variant of the anthropomorphic conception of justice that the FTT needed evidence of the normal characteristics of legitimate trade in the grey mobile phone market, or any other expert evidence, in order fairly and justly to apply the required impersonal standard.

66. Nor do we consider that the FTT fell into an error of law when noting that:

> 'it would make no difference if I replaced "the reasonable businessman" with "I"'

In our judgment, taking the Second FTT Decision as whole, this was no more than the application of the appropriate standard explained by Lord Reed, "I" being a reference to the FTT and, therefore, to the anthropomorphic conception of justice.

67. As we have indicated in relation to Ground 1, in our judgment the FTT made no error of law in applying the required standard in reaching its decision (in paragraph [84] of the Second FTT Decision) that S&I should have known, by reference to the 'five indicia' and the other findings of fact made on the basis of

the evidence, that the only reasonable explanation of the deals was that they were connected to VAT fraud. As the FTT said in that paragraph, that conclusion was reached without considering what additional information S&I could have obtained.

68. Having said that, however, in our judgment the FTT did fall into error in relation to the additional, independent and alternative conclusion in paragraph [85] of the Second FTT Decision, that 'the only reasonable response [to the concerns detailed in the First FTT Decision] would have been to make the further investigations described in paragraph 215 [of the First FTT Decision], and that those investigations would have revealed that there was a connection to fraud."

69. As we have said, we regard the reference in paragraph [215] of the First FTT Decision to such further investigations as part of the FTT's reasoning as to why S&I should have known of the connection to fraud. On that basis, it is open to us to assess the rationality and relevance in relation to the correct legal test (1) of the FTT requiring steps to be taken which consisted of insisting on the source of each new transaction being chased down the chain by an independent third party (who undertook not to divulge details of the suppliers' identities) as a condition for the completion of a transaction, or of insisting on being given adequately secured personal indemnities from the individuals in charge of a trader's suppliers against the loss of the input tax at stake as a result of any fraud in the chain, and (2) of the FTT's conclusion that 'in each case where there was a fraudulent trader this would … have revealed the fraud'.

70. In this exercise, particularly, it is important not to lose sight of common sense. We also bear in mind the guidance of the CJEU in *Stroy trans EOOD* to which we have made reference above.

71. In our judgment, the FTT erred in law in taking into account in its legal reasoning in relation to its alternative conclusion at paragraph [85] of the Second FTT Decision the further investigations mentioned at paragraph [215] of the First FTT Decision, because there were no grounds for it to do so. Those further investigations were not raised with S&I's witnesses and were not the subject of any evidence, at least no such evidence was referred to. In our judgment, in the circumstances, there can have been no reasonable and proper basis for advancing them and relying upon them.

72. Although it is no part of our function to find facts, and without it forming any part of our reasoning, we state that the further investigations mentioned by the FTT appear to us to have been both commercially impracticable and outside the ambit of checks to insure the integrity of the VAT system which are the responsibility of traders (as opposed to national tax authorities). In the absence of any evidence to the contrary, we doubt the possibility of any ordinary trader in S&I's position being able to engage any independent third party to chase a transaction down the chain, even if such third party undertook not to divulge details of the suppliers' identities. We know that this was a formidable task even for HMRC, equipped as it was with the necessary statutory powers to call for information and documents. Such 'chasing down the chain' seems to us to be pre-eminently a check within HMRC's rather than any trader's responsibility.

73. In the absence of any evidence to the contrary, we also doubt the practicality of S&I requiring from those behind its suppliers personal secured indemnities against the possibility of loss of input tax deductibility. As Mr Lasok submitted, in the context of an industry which was known to be extensively affected by fraud, if any individual had offered or given such an indemnity he might reasonably have been suspected of being a fraudster himself and his indemnity of being worthless. But there was no evidence that such indemnities were generally sought or given and, in those circumstances, it cannot be assumed that any trader, honest or not, would have been prepared to give such an (open-ended) indemnity, rather than trade with another counterparty who did not demand it.

74. What, then, would S&I have discovered by pursuing the further investigations mentioned at paragraph [215] of the First FTT Decision? We do not consider that there were any grounds on which the FTT could reasonably conclude that 'in each case where there was a fraudulent trader this would have revealed the fraud' (cf. paragraph [215] of the First FTT Decision). In our judgment, in the absence of any evidence on the point, it was not open to the FTT to conclude that S&I would have discovered that such further investigations were possible to implement and, although it is not necessary for our decision to take the point any further, absent evidence to the contrary, we also consider that far from the only reasonable explanation for the impossibility of the implementation of such further investigations being any connection with fraud, an entirely reasonable explanation would have been the counterparties' honest reluctance to engage in such complex and commercially risky precautions, especially given that there were (we assume, in the absence of evidence to the contrary) plenty of traders, other than S&I, who would trade without insisting on them.

75. For these reasons we hold that there was no error of law in the FTT's application of the 'reasonable businessman' test in reaching its conclusions as expressed in paragraph [84] of the Second FTT Decision, but that it did err in law in reaching its conclusions as expressed in paragraph [85] of that Decision and the reasoning in that paragraph cannot be relied on to support the conclusion that S&I should have known that its transactions were connected to VAT fraud.

GROUND 4: HMRC wrongly failed to lead evidence as to what a reasonable businessman would have done.

76. For the reasons given in paragraphs [64] to [67] above, we reject this ground of appeal.

GROUND 5: The FTT was not entitled to find on the evidence before it: (a) that S&I was aware that contemporaneously with its purchases and sales there was a series of virtually contemporaneous purchases and sales by UK traders; or (b) that S&I knew that the phones were being traded in the UK for the purposes only of exporting (dispatching) them – and the FTT erred in law in concluding from the facts found by it that the only reasonable explanation for the transactions was that they were connected with fraud

77. Underlying this attack by S&I on the FTT's decision is the proposition advanced by Mr Lasok that all of the 'five indicia' are entirely consistent with ordinary (legitimate) grey market mobile telephone transactions and are not capable of

forming the basis for a conclusion of fact that the only reasonable explanation for the 79 transactions was that they were connected to fraud. Mr Lasok makes the observation: 'After all, the skill of the fraudsters was to insert themselves into a legitimate market without being observed'.

78. While not seeking to challenge the other three of the 'five indicia', S&I does submit that it was not open on the evidence for the FTT to find that S&I knew that there was a chain of transactions before each of its acquisitions, or that S&I knew that the phones were being traded in the UK for the purposes only of exporting (dispatching) them.

79. It seems to us that the absence of any evidence before the FTT as to the characteristics of legitimate grey mobile phone market trading makes it impossible for S&I to substantiate its proposition that all of the 'five indicia' are consistent with legitimate transactions. In any case, as we have said, it is not required of HMRC in cases such as this that they should lead evidence of the way legitimate trade in the grey market is conducted for the purpose only of showing by comparison that the deals in issue in an appeal display different objective factors. What is required is that the Tribunal should be satisfied by reference to objective factors established by the evidence that the supplies in issue were connected to fraud.

80. We have already held that we can discern no error of law in the FTT's decision that the only reasonable explanation of the 79 deals was that they were connected to fraud. This was on the basis that the findings of fact comprised in the 'five indicia' and the other findings of fact made on the basis of the evidence were not, and could not be, impugned. However, under Ground 5, S&I seeks to challenge the two of the 'five indicia' which we have indicated.

81. At paragraph [70] of the Second FTT Decision, the FTT's reasoning was that because S&I knew that traders did not want to hold stock (a primary fact found from the evidence heard) S&I knew that its transactions were part of a back-to-back chain of acquisitions and sales. Given that the phones were of non-UK manufacture (Nokia was given as an example) and that the phones dealt in were mostly of central European specification with plugs not intended for the UK market (see: the 6th point made under the heading "Factor 4" in paragraph [201] of the First FTT Decision) it seems clear to us (and an obvious inference for the FTT to draw) that the phones must have passed through at least two entities (a non-UK supplier and S&I's actual supplier) before reaching S&I. This may not be enough to justify the conclusion that there was a series of virtually contemporaneous purchases and sales by UK traders before the sale to S&I but we consider that it is enough to justify the conclusion that there was at least one contemporaneous purchase and sale before the sale to S&I and, in all the circumstances, that that conclusion rationally supports the FTT's inference that the only reasonable explanation of S&I's deals was that they were connected to fraud.

82. In paragraph [72] of the Second FTT Decision, the FTT, noting that the phones traded in were mostly of central European specification with plugs not intended for the UK market, concluded that S&I must have known that the phones passed speedily through the chain (however long it was) without conversion for the UK market. That seems to us to be an impeccable and unimpeachable finding.

83. The FTT then asked itself what the explanation for that could be. It suggested to itself three possibilities – an approach that we consider was thorough and well balanced and which we did not understand S&I to criticise. The first was that the phones were acquired in the UK with UK specification but were converted in the UK to central European specification with the intention of being sold into the EU (paragraph [74] of the Second FTT Decision). It rejected that as unreasonable on the basis that such conversions would not have been done on a speculative basis. That inference seems to us to disclose no error of law.

84. The second possibility was that the phones were being bought and sold as commodities in a price arbitrage market in which their precise specification did not matter. This possibility was rejected as unreasonable because the FTT considered that such arbitrage transactions would not require the movement of phones across frontiers and the evidence was that all the consignments of phones dealt in by S&I were physically in the UK before export (dispatch) by them out of the UK. Again, that inference seems to us to disclose no error of law.

85. The third and final possibility was that the phones were in the UK so that they could be exported (dispatched) out of the UK. The FTT concluded that this was the only reasonable explanation for the fact (which must have been known by S&I) that the phones passed speedily through the chain without conversion for the UK market.

86. S&I object in this appeal to this finding, again on the basis that there was no evidence before the FTT that legitimate trades in the grey mobile phone market did not exhibit the characteristic of comprising phones of central European specification with plugs not intended for the UK market. Again, we reject this submission because we do not accept that evidence of the nature of such legitimate trades is necessary to enable the FTT to determine whether the only reasonable explanation for the deals in issue before it was that they were connected to VAT fraud and that S&I should have known that. The FTT's conclusion on this point appears to us to be supported by the evidence before it.

87. For these reasons we conclude that no error of law in the FTT's conclusions is apparent by reason of the arguments advanced under Ground 5.

Disposition

88. For the reasons given above the appeal is dismissed.

THE HON MRS JUSTICE ASPLIN JUDGE JOHM WALTERS QC

JUDGES OF THE UPPER TRIBUNAL

RELEASE DATE: 31 MARCH 2015