[2016] UKUT 0123 (TCC)

Appeal numbers: UT 2014/0072
UT/2015/008

PROCEDURE – MTIC appeals - allegations of knowledge that appellant's transactions orchestrated and contrived and formed part of an overall scheme to defraud the Revenue - whether HMRC's statement of case alleged dishonesty and therefore whether sufficiently particularised - whether standard disclosure of relevant documents appropriate

UPPER TRIBUNAL
TAX AND CHANCERYCHAMBER

BETWEEN

E BUYER UK LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S

REVENUE & CUSTOMS **Respondents**

AND BETWEEN

THE COMMISSIONERS FOR HER MAJESTY'S

REVENUE & CUSTOMS **Appellants**

-and-

CITIBANK NA **Respondent**

TRIBUNAL: Mr Justice Nugee
Judge Timothy Herrington

Sitting in public at The Rolls Building, Fetter Lane London EC4A 1NL on 7 and 8 December 2015

John Wardell QC and David Scorey QC, instructed by KPMG LLP, for E Buyer UK Limited ("E Buyer")

James Puzey and Howard Watkinson, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs ("HMRC"), for the Respondents to the E Buyer Appeal

Jonathan Kinnear QC, James Puzey and Howard Watkinson, Counsel, instructed by the General Counsel and Solicitor to HMRC, for the Appellants to the Citibank Appeal

Michael Conlon QC and David Scorey QC, instructed by Hogan Lovells International LLP, for Citibank NA ("Citibank")

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DECISION

Introduction

1. This decision relates to two appeals that raise the same important point of principle regarding the level of particularity to be contained in a statement of case in a Missing Trader Intra-Community (**"MTIC"**) appeal. In particular, in both of the appeals which are the subject of this decision HMRC allege that the appellant's transactions formed part of an overall scheme to defraud the Revenue, that the scheme involved an orchestrated and contrived series of transactions and that there were features of those transactions which demonstrate that the appellant knew or ought to have known that this was the case.

2. E Buyer and Citibank are the appellants in the appeals that are before the First-tier Tribunal (**"FTT"**). They both contend that an allegation of the nature described above is an allegation of dishonesty or wrongdoing which if it is to be made must be pleaded with sufficient particularity and in accordance with the pleading strictures applicable in civil fraud litigation. They contend that HMRC have failed to follow that in these appeals. In their appeal E Buyer also contend that they should be given standard disclosure of relevant documents by HMRC as would be the case in a trial in the High Court for civil fraud.

3. HMRC contend that the pleadings simply allege, in accordance with the well established *Kittel* principle, that the appellant knew or should have known that its transactions were connected to fraud, that such a pleading does not amount to an allegation of dishonest behaviour and does not require to be particularised in the manner described at [2] above.

Background

The E Buyer Appeal

4. E Buyer's appeal before the FTT is not typical of MTIC cases commonly heard in that tribunal which often involve small companies managed and controlled by inexperienced businessmen with little knowledge of the nature of the goods to which their transactions relate. E Buyer is a large established on-line retailer of "white goods" with an annual turnover in excess of £200 million. It makes purchases from both authorised distributors and dealers and also from the parallel/grey market.

5. E Buyer's appeal concerns input tax incurred by it in respect of 289 export transactions undertaken in the periods 06/10 to 9/11. The total amount of tax in issue is £6,740,113.23. HMRC allege that these 289 deals have been traced back to tax losses connected with fraud. The fraud in this case is said to involve both the "vanilla" version, where transactions carried out by the taxpayer can be traced directly to a fraudulent tax loss resulting from 37 defaulting traders, and the "contra trading" version where the transactions carried out by the taxpayer can be traced through a "clean" chain to a trader involved in covering up the tax losses of fraudulent

defaulting traders in an apparently distinct but in reality linked "dirty chain". Accordingly, HMRC have by various decisions notified by letter between 31 January 2013 and 28 April 2014 denied E Buyer input tax deduction in respect of these transactions on the basis that the transactions were connected with the fraudulent evasion of tax and that E Buyer knew or should have known of the connection.

6. Notices of Appeal were lodged with the FTT challenging each of these decisions. On 12 February 2014 HMRC filed its statement of case (**"SOC"**). The core allegations against E Buyer were set out at [37] and [78] of the SOC as follows:

> "37. The Commissioners contend that the Appellant's transactions formed part of an overall scheme to defraud the Revenue, that the scheme involved an orchestrated and contrived series of transactions, and that there were features of those transactions which demonstrate that the Appellant knew or ought to have known that this was the case. It is not necessary to prove the identities of those responsible for orchestrating the overall scheme in order to resolve the appeal brought by the Appellant…
>
> 78. The circumstances of the Appellant's trading and those it was trading with could or should have left no doubt that its transactions were connected to fraud. The Appellant was well aware of the risks presented by trading in the wholesale market for these goods with companies that were small, recently established and unknown within the industry and yet continued to do so even when informed of tax losses in its transaction chains. The inevitable conclusion from this is that it must have known or should have known of its connection to deals and traders that were fraudulent. The information known to the Appellant about its suppliers and customers and how it reacted to that information make good this point."

7. The SOC also includes the following conclusions at [117] to [120]:

> "117. Prior to 2008 the Appellant as a company had no history or experience in the wholesale market for electrical goods nor had it experience in the dispatch or export of such goods. It created the B2B team to address this market. However, so far as the Commissioners have been able to establish its trading in this wholesale market was almost exclusively connected to fraud. This cannot be coincidental.
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> 118. The Appellant's trading methods and procedures for the rest of its business were not replicated for the wholesale export deals. The Appellant found itself trading with small or medium sized entities which had usually only been in existence for a short period of time and which are no longer trading now.
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> 119. Those entities can be shown in many cases to have links to previous fraudulent MTIC activity. The Appellant was well aware of the risks it faced of becoming involved in transactions linked to such activity.
>
> 120. The Appellant failed to act on the warning signs that its wholesale export business was linked to fraud. The natural and logical inference from the matters set out above is that they must have known or should have known that its trading was connected to fraud."

8. On 2 June 2014 E Buyer applied to the FTT for two directions as follows:

(1) the SOC should be struck out or alternatively that HMRC should provide E Buyer with further and better particulars of their pleaded case by responding to E Buyer's Request for Further Information attached as an Appendix to the application; and

(2) both parties should provide disclosure by list (with inspections seven days thereafter) of all documents relevant to the issues in the appeal, namely, documents on which a party relies; and documents which (i) adversely affect that party's case, (ii) adversely affect the other party's case, or (iii) support the other party's case.

9. This application came before Judge John Walters QC who in a decision released on 23 September 2014 dismissed the application. It is that decision which is the subject of an appeal by E Buyer to this tribunal.

The Citibank Appeal

10. Citibank's appeal before the FTT is similarly not a typical MTIC appeal. Citibank is a sophisticated global financial institution, regulated in the US, the UK and elsewhere. Its appeal involves the purchase and sale of European Union Emissions Allowances (**"EUAs"**), a market in which developed in 2009 resulting in these instruments being traded in the same manner as other sophisticated financial derivatives.

11. Citibank's appeal concerns an assessment for just over £10 million in respect of input tax claimed in the period 09/09 in respect of the trading by Citigroup Global Markets Ltd (**"CGM"**), a member of Citibank's VAT Group, for trades in EUAs which took place in July 2009. The assessment was made, relying on the *Kittel* principle, on the basis that in HMRC's opinion Citibank had reclaimed VAT on sales of EUAs for which it was not entitled because, HMRC alleged, Citibank knew or ought to have known that its transactions in these instruments were connected with fraud. The assessment was reduced on review in a decision made by letter on 27 February 2014 to £9,893,821.

12. A Notice of Appeal was lodged with the FTT challenging this decision. On 22 April 2014 HMRC lodged its SOC. The core allegations against Citibank are set out at [49] and [96] of the SOC as follows:

> "49. The Respondents contend that the Appellant's transactions formed part of an overall scheme to defraud the Revenue, that the scheme involved an orchestrated and contrived series of transactions, and that there were features of those transactions which demonstrate that the Appellant knew or ought to have known that this was the case. It is not necessary to prove the identities of those responsible for orchestrating the overall scheme in order to resolve the appeals brought by the Appellant…
>
> 96. The trade by CGM in EUAs in July 2009 was connected with fraudulent evasion of VAT by 3 defaulting traders. CGM was well aware of the risks of trading in this market by the 8th July 2009 and recognised that its principal supplier at that time,

SVS was a suspect trader. However, CGM continued to buy millions of pounds worth of EUAs regardless of its own expressed concerns, both general and particular. The only reasonable explanation for its behaviour is that it knew or should have known of its connection with VAT fraud."

13. On 23 May 2014 Citibank applied to the FTT for a direction that HMRC give further and better particulars of the SOC. This application came before Judge Barbara Mosedale on 3 November 2014. In a decision released on 28 November 2014 (amended on 2 January 2015) the FTT decided that the SOC failed to make it clear whether or not HMRC was alleging a dishonest state of mind against Citibank. The FTT also decided that, in the absence of an application to amend the SOC to that effect, it would not be open to HMRC to allege at the hearing of the appeal that Citibank knew its transactions were contrived, or that it knew that its transactions facilitated fraud by others, or indeed that Citibank knew its transactions were connected to fraud. It is that decision which is the subject of an appeal by HMRC to this tribunal.

14. Consequently it can be seen that two experienced FTT judges who have each heard many MTIC appeals have come to opposite conclusions on the question as to whether allegations of the nature pleaded at [38] and [80] of the E Buyer SOC and at [49] and [96] of the Citibank SOC have to be pleaded with the level of particularity to be expected when allegations of dishonesty are made in civil fraud proceedings.

15. In the circumstances it is appropriate that this Tribunal, in determining the appeals before us, should give general guidance as to the proper approach to be taken by HMRC in SOCs which relate to MTIC appeals that allege knowledge on the appellant's part that its transactions in respect of which input tax is denied are connected to fraud in the manner alleged in the E Buyer and Citibank SOCs.

Relevant case management powers

16. We are conscious of the fact that both of the decisions which are the subject of the appeals before us relate to case management decisions and it is well-established that this Tribunal will be slow to interfere with the proper exercise by the FTT of its discretion in case management decisions. The position was summarised by Norris J in this Tribunal in *Goldman Sachs International and another v Revenue and Customs Commissioners* [2009] UKUT 90 (TCC), at [23] and [24]:

> "23. … I think the Upper Tribunal should exercise extreme caution in entertaining appeals on case management issues. Mr Gammie QC for HMRC drew my attention to the decision of the Court of Appeal in *Walbrook Trustee v Fattal & Others* [2008] EWCA Civ 427, not as establishing any novel proposition but as containing in paragraph 33 the following convenient statement from the judgment of Lord Justice Lawrence Collins:
>
> > "I do not need to cite authority for the obvious proposition that an appellate court should not interfere with case management decisions by a judge who has applied the correct principles and who has taken into account matters which should be taken into account and left out of account matters which are irrelevant, unless the court is satisfied that the decision is so plainly wrong that

it must be regarded as outside the generous ambit of the discretion entrusted to the judge."

24. I am clear that the principle applies with at least as great, if not greater, force in the tribunals' jurisdiction as it does in the court system."

17. Unsurprisingly, both HMRC, as respondent to E Buyer's appeal, and Citibank, as respondent to HMRC's appeal, rely on this statement for their contentions that the respective decisions made in their favour should not be interfered with.

18. It is convenient to set out the relevant case management powers under the First-tier Tribunal (Tax Chamber) Rules 2009 (**"the FTT Rules"**).

"Overriding objective and parties' obligation to co-operate with the Tribunal

2. (1) The overriding objective of these Rules is to enable the Tribunal to deal with cases fairly and justly.

(2) Dealing with a case fairly and justly includes—

(a) dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties;

(b) avoiding unnecessary formality and seeking flexibility in the proceedings ...

(3) The Tribunal must seek to give effect to the overriding objective when it–

(a) exercises any power under these Rules; or

(b) interprets any rule or practice direction.

(4) Parties must—

(a) help the Tribunal to further the overriding objective; and

(b) co-operate with the Tribunal generally.

Case management powers

5. (1) Subject to the provisions of the 2007 Act and any other enactment, the Tribunal may regulate its own procedure.

(2) The Tribunal may give a direction in relation to the conduct or disposal of proceedings at any time, including a direction amending, suspending or setting aside an earlier direction.

(3) In particular, and without restricting the general powers in paragraphs (1) and (2), the Tribunal may by direction–

...

(d) permit or require a party or another person to provide documents, information or submissions to the Tribunal or party;

…

Summoning or citation of witnesses and orders to answer questions or produce documents

16 (1) On the application of a party or on its own initiative, the Tribunal may–

…

(b) order any person to answer any questions or produce any documents in that person's possession or control which relate to any issue in the proceedings.

(3) No person may be compelled to give any evidence or produce any document that the person could not be compelled to give or produce on a trial of an action in a court of law in the part of the United Kingdom where the proceedings are due to be determined.

Respondent's statement of case

…

25 (2) A statement of case must-

…

(b) set out the respondent's position in relation to the case.

Further steps in a Standard or Complex case

…

27 (2) Subject to any direction to the contrary, within 42 days after the date the respondent sent the statement of case (or, where there is more than one respondent, the date of the final statement of case) each party must send or deliver to the Tribunal and each other party a list of documents-

(a) of which the party providing the list has possession, the right to possession, or the right to take copies; and

(b) which the party providing the list intends to rely upon or produce in the proceedings."

19. It is clear that the Rules provide a wide variety of powers to give effect to the overriding objective which includes dealing with the case proportionately in the light of its importance, the complexity of the issues and the anticipated costs. We shall have regard to this observation when considering the issues that are before us on these appeals.

The decisions of the FTT

The E Buyer Decision

20. The FTT set out the basis of E Buyer's application in relation to the SOC at [7] of the decision. This was that HMRC's case was defective in that there was an insinuation on HMRC's part that E Buyer itself was a knowing party to a deliberate scheme to defraud HMRC and the SOC did not satisfy the basic requirements of civil fraud pleadings because there was no proper plea of fraud, making the SOC defective. At [13] the FTT recorded E Buyer's submission that the SOC contained much prejudicial material about E Buyer's suppliers and customers but it was nowhere alleged that E Buyer knew or alternatively should have known of this information. At [14] the FTT recorded E Buyer's submission that the SOC was unacceptably deficient in that, among other things, it did not identify what steps could (and on HMRC's case, should) have been taken by E Buyer which would have alerted it to the fact of the alleged fraud.

21. In relation to the disclosure issue the FTT recorded at [18] E Buyer's submission that it was not sufficient in an MTIC appeal for HMRC to limit disclosure to the bare minimum required by Rule 27 of the Rules, but they should at the same time serve a list of those other documents in their possession which related to the transactions in question but on which they did not intend to rely and should allow an appellant or his advisers access to those documents.

22. The FTT's reasoning on the SOC issue was set out at [33] to [38]:

> "33. If I was of the view that the SOC did not set out HMRC's position in relation to the case, I would direct HMRC, in the exercise of the Tribunal's case management powers in rule 5 of the Rules, to amend it so that it did.
>
> 34. However, in my view the SOC adequately sets out HMRC's position in relation to the present appeal, which is that in respect of all the transactions in issue they are connected with fraudulent evasion of VAT by identified defaulting traders (see paragraph 46 of the SOC) which have caused tax losses (paragraph 45 of and Annexure E to the SOC), and that E Buyer knew or should have known of that connection (those connections).
>
> 35. I accept that there is no allegation made by HMRC of involvement as a co-conspirator in any fraud, but instead there is an allegation of knowledge of the connection with fraud. The references in the SOC to an overall scheme to defraud the revenue involving an orchestrated and contrived series of transactions are, I accept, details as to relevant circumstances surrounding E Buyer's transactions, which HMRC may relevantly allege in order to establish, if they can, the context in which E Buyer's transactions took place. Establishing this context will be relevant as it will assist the tribunal in determining what E Buyer knew or ought to have known (see: the passage from the judgment of Christopher Clarke J in *Red 12 Trading Limited v R&C Commissioners* [2009] EWHC 2563 (Ch) at [109] to [111] cited with approval by Moses LJ in *Mobilx Ltd (in administration) v R&C Commissioners* [2010] STC 1436 at [83]).

36. The same comment can be made about the detail in the SOC relating to E Buyer's suppliers and customers. HMRC can legitimately say that that detail is relevant in establishing the context in which E Buyer's transactions took place.

37. This should not embarrass E Buyer, which is not obliged to put in a defence to the SOC – a material distinction between the Tribunal's procedure and that in the High Court in civil litigation – and I see no vice in requiring E Buyer to wait to read HMRC's witness evidence to ascertain more particularity about what is alleged as to what E Buyer knew or ought to have known. I would expect the clarity which Mr Wardell demanded to be achieved at that stage, and, if it is not, then I agree with Mr Puzey that the proper and convenient (and proportionate) course would be for E Buyer to apply to the Tribunal for a (properly focussed) direction requiring HMRC to provide documents, information or submissions pursuant to rule 5(2)(d) of the Rules.

38. On the question of the basis of the alternative allegation that E Buyer should have known of the alleged connection with fraud, I accept that E Buyer may legitimately ask what further information it could have found out which would have led to the conclusion that the only explanation for its transactions was that they were connected with fraud. But the answer to that question cannot be determinative of the "should have known" issue, the answer to which will be derived from the Tribunal's consideration of all the relevant evidence as a whole, including, of course, E Buyer's witnesses' evidence of their trading practice and state of knowledge."

23. The FTT's reasoning on the disclosure issue was set out at [40]:

"40. As to E Buyer's application at this stage for "standard disclosure" going beyond what is provided for by rule 27 of the Rules, I reject that also. Litigation in this tribunal is intended to conform to a different model from litigation in the High Court and the Rules establish the framework within which litigation in this tribunal is to be carried on. Rule 27 provides for the normal disclosure in a standard or complex case and I consider it would not be appropriate for me, at this stage in this litigation, to require wider disclosure than that required by rule 27. It is, in my view, no answer to complain in this forum about the inadequacy of the terms in which rule 27 is framed."

The Citibank Decision

24. The FTT recorded at [8] that the basis of Citibank's application to the FTT in relation to the SOC was that there were possible inferences of fraud from the SOC but fraud was not clearly pleaded; it considered overall the SOC lacked the necessary details and in particular the appellant was prejudiced by not knowing what was alleged against it and therefore was unable to commence investigations into the matters alleged.

25. The FTT recorded at [18] HMRC's submission that where HMRC denied the taxpayer input tax recovery under the rules established by the Court of Justice of the European Union (CJEU) in *Kittel* on the grounds that the taxpayer knew its transactions were connected to fraud, HMRC were not making an allegation of dishonesty. It also records HMRC's submission that as a result, the special pleading rules which apply to fraud did not apply to MTIC cases.

26. At [22] the FTT recorded HMRC's submission that all they have to prove is actual knowledge by the appellant that its transactions in issue were connected to fraud and that they would not have to prove that the appellant understood the nature of the fraud involved in order to succeed.

27. The FTT deals with these submissions at [23] to [27]:

> "23. HMRC's position disintegrates, however, when I consider what facts HMRC seek to prove in order to prove that the appellant knew its transactions were connected to fraud. Most significantly, as is almost inevitable in a case where MTIC fraud is alleged, the SOC here alleges that the appellant knew that its transactions were contrived. As an example of this §49 of the SOC reads:
>
> > "The respondents contend that the appellant's transactions formed part of an overall scheme to defraud the Revenue, that the scheme involved an orchestrated and contrived series of transactions, and that there were features of those transactions which demonstrate that the appellant knew or ought to have known that this was the case…"
>
> 24. In my view, if an appellant is shown to know in advance that its purchase and sale were orchestrated by a third party in order to perpetrate a fraud on HMRC (or indeed on anyone), its decision to proceed with the transactions knowing this would be dishonest.
>
> 25. In other words, as part of its case that the appellant knew that its transactions were connected to fraud, HMRC seek to prove that the appellant acted in a dishonest fashion: they seek to prove that it went ahead with transactions which it knew were orchestrated for the purpose of fraud.
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> 26. The same point was made by Judge Wallace in *Blue Sphere* VTD 20694 at [29]:
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> > "There is however an important difference between the person who knowingly participates in fraud and the person who takes part in a fraudulent chain without knowing that he is doing so notwithstanding that he should have known. A person who knowingly participates in a transaction connected with fraudulent evasion is himself committing fraud…."
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> 27. Mr Justice Briggs said in *Megtian Ltd* [2010] EWHC 18 (Ch) at [41]:
>
> > "…A person who knows that a transaction in which he participates is connected with fraudulent tax evasion is a participant in that fraud. That person has a dishonest state of mind…" "

28. The FTT took the view that the Court of Appeal in *Mobilx,* the leading domestic authority on the application of the *Kittel* principle and which we return to later, assumed that behaviour caught by the principle could be described as dishonest. It said at [29] to [32]:

> "29. Moreover, I note that the Court in *Mobilx* certainly appeared to describe dishonest behaviour: see, for instance [84] where Millett LJ referred to a trader who
>
> > "has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable reward over a short space of time."
>
> Further, Millett LJ was quite clear in the same paragraph that such behaviour had to

be 'put' to the witness in cross examination; in other words, the Court of Appeal did consider such behaviour to be dishonest, as it ruled the witness had to be given a specific opportunity to give an explanation before adverse inferences could be drawn.

30. It is true that, earlier in the decision, Millett LJ twice (at [20] and [41]) drew a distinction between a fraudulent trader and one who knew or ought to have known its transaction was connected to MTIC fraud. Does that mean I should infer from this that the Court of Appeal ruled that a person who 'merely' knew its transactions were connected with fraud was not dishonest? I do not think so.

31. The context of what Millett LJ said was in a reference back to what the CJEU said at [53] and [56] of its decision. In these two paragraphs, the CJEU drew a distinction between 'where tax is evaded by the taxable person himself' ([53]) and a person who knew or should have known its transaction was connected to fraud ([56]).The former transaction described at [53] was not an economic activity, so there would be no right to recover input tax; whereas the transaction described at [56] was an economic activity but one in which the right to deduct input tax was lost. In these two paragraphs, the CJEU was not drawing a distinction between honesty and dishonesty; it was drawing a distinction based on whether the transactions were an economic activity or not. Millett LJ, no more than the CJEU, stated that a person in the second category was honest if, although not actually fraudulently evading payment of VAT by its transaction, that person nevertheless entered into a transaction knowing it facilitated fraud by someone else. On the contrary, it stands to reason that such a person is not acting honestly. And that explains why later at [84] Millett LJ said such allegations had to be specifically put to the witness.

32. So I do not consider that there is anything in *Mobilx* which casts any doubt on what was said by Briggs J in the passage above, and which, for the reasons I have given at 25, must be right in law."

(The references to Millett LJ in these paragraphs are in fact references to what Moses LJ said).

29. The FTT gave further reasons for rejecting HMRC's submissions at [33] to [35]:

"33. I note in passing that I consider HMRC wrong for another reason. In my view, the CJEU in *Kittel*, when referring to 'connected with' fraud used the word 'connected with' in the sense that the appellant's transaction facilitated the fraud. The justification given by the CJEU in *Kittel* for denial of input tax by someone who was not the fraudster, was as follows:

"[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 the 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."

34. In [57] and [58] the CJEU refers to aiding the perpetrators, and refusing input tax recovery to knowing parties to make it more difficult to commit fraud. The underlying assumption the CJEU here makes is that the participation of the taxable person making the input tax reclaim actually facilitated the fraud: if the appellant's actions did not facilitate the fraud, then the appellant would not need penalising for aiding the perpetrator of the fraud, nor would refusing the input tax recovery make it more difficult for the fraudster to carry out the fraud. Here, therefore, is the guide to interpretation of what the CJEU meant by 'connected'. It meant it in the sense of a connection which facilitated the fraud. This is therefore the natural extent of the decision in *Kittel*. Not every remote connection to fraud is relevant: it is only the connections which facilitate the fraud which matter.

35. Therefore, the test in *Kittel* is whether the appellant knew (or ought to have known) its transaction was connected to (in the sense of facilitating) fraud. In my view a person who entered into a transaction knowing it facilitated fraud necessarily has a dishonest state of mind."

30. The FTT found at [37] to [42] of the decision that this conclusion had the following consequences for the SOC:

"37. Because there is an express allegation in the SOC that the appellant knew its transactions were contrived and, separately, because an allegation of knowledge of connection to fraud necessarily connotes an allegation of knowledge that the transaction facilitated fraud, I find that HMRC's SOC does imply that the appellant acted dishonestly. In contrast, at the hearing, as I have said, HMRC's position was that they did not allege dishonesty against the appellant and made no express allegation to that effect in the SOC.

38. The appellant said the SOC left it uncertain whether allegations of dishonesty were made against it or just against third parties. I consider this confusion justified bearing in mind HMRC's statement at the hearing that no dishonesty was alleged, which contradicted the allegation in the SOC that the appellant knowingly entered into transactions contrived for the purpose of fraud.

39. Allegations of fraud must be clearly made, and HMRC's position, bearing in mind what was said at the hearing, was not clear.

40. HMRC ought to apply to amend its statement of case to make it clear whether or not it is alleging a dishonest state of mind against the appellant. And, if it does not amend its SOC to allege a dishonest frame of mind, at the hearing it must not ask the Tribunal to find that the appellant knew its transactions were contrived, nor the appellant knew its transactions facilitated fraud by others, nor, indeed, that the appellant knew its transactions were connected to fraud.

41. If, on the other hand, HMRC amends the SOC to say that a dishonest state of mind is alleged against the appellant, then it may retain the allegations that are currently in the SOC that the appellant knew that its transactions in issue in this appeal were contrived and that it knew its transactions were connected to fraud.

42. I note in passing that a pleading that an appellant 'knew its transactions were connected to fraud' has, so far as I am aware, always been considered by this Tribunal in MTIC cases to be a clear pleading of dishonesty. Nothing in this decision should be taken as suggesting otherwise: nevertheless, in this case, bearing in mind HMRC's position at the hearing, HMRC must clarify if they are pleading a dishonest state of mind."

31. The FTT set out a summary of its conclusions at [127] to [129] which in so far as relevant provide as follows:

"127. The Request for information was flawed in many respects; in some instances it asked for information which was actually pleaded (eg the deal chains); in others it asked for information to which it is plainly not entitled (such as exhaustive facts to be relied on at the hearing); in many others it asks for details and disclosure to which it is entitled, but not at this stage.

128. The appellant is entitled to have the respondent's case set out in its statement of case and it is no answer for the respondents to say (at this point in time) that they will rely on their (yet to be served) witness statements to remedy any defects in the statement of case. But on the other hand, the appellant is not entitled to require the SOC to contain more than the allegations and the primary facts relied on to establish them. The appellant criticises the preamble to the SOC which stated that 'full particulars' would be contained in the witness evidence, but this records no more than the law. HMRC are not directed to reply to the Request or any part of it.

129. Nevertheless, I do consider that the SOC was seriously flawed and some of the appellant's complaints about it were justified. The SOC was seriously flawed as either HMRC intended to allege behaviour amounting to dishonesty but failed to plead it with clarity or HMRC did not intend to allege behaviour amounting to dishonesty but nevertheless insinuated it. In a few instances, it failed to plead the primary facts relied on. In summary, the defects were:

(1) The SOC failed to make clear whether or not HMRC is alleging a dishonest state of mind against the appellant. If HMRC do not (successfully) apply to amend the SOC to allege a dishonest frame of mind, they must not make allegations at the hearing that the appellant knew its transactions were contrived, or that the appellant knew its transactions facilitated fraud by others, or indeed that the appellant knew its transactions were connected to fraud.

…"

Grounds of Appeal

The E Buyer decision

32. In a decision notice dated 30 December 2014 the Upper Tribunal (Judge Berner) gave E Buyer permission to appeal on the following grounds:

(1) The FTT erred in rejecting as necessary and proportionate E Buyer's application for further and better particulars of the SOC. Specifically, although the FTT correctly identified the gravamen of E Buyer's complaint as lack of

clarity in the SOC, the FTT erred in rejecting E Buyer's criticisms and further erred by concluding that the SOC adequately set out HMRC's case;

(2) the FTT should have accepted the main thrust of E Buyer's application, namely that the case advanced by HMRC was akin to a civil fraud case which suffered from major internal inconsistencies and lack of clarity and to which the usual procedural safeguards and procedures should apply; and

(3) the FTT erred in refusing E Buyer's application that HMRC should provide disclosure by list of relevant documents and wrongly concluded that the procedure adopted in the FTT was inflexibly intended to conform to a different model of litigation to that adopted in High Court litigation. The FTT should have concluded that HMRC should provide disclosure of relevant documents at an early juncture to enable E Buyer to conduct its own investigation of the circumstances surrounding its transactions.

33. In its application for permission to appeal E Buyer sought an order that HMRC provide further and better particulars of their SOC by responding substantively to the requests made in that regard and an order that HMRC provide disclosure of relevant documents by list.

The Citibank decision

34. In a decision notice dated 29 January 2015 the FTT (Judge Mosedale) granted HMRC permission to appeal on the following grounds:

(1) the FTT erred in concluding that an allegation that the appellant knew that its transactions were connected with fraud, amounts to an allegation that they acted dishonestly; and

(2) the FTT erred in concluding that the CJEU's use of the term "connected with fraud" in *Kittel* indicated or meant that an appellant's transactions "facilitated fraud".

35. In its application for permission to appeal HMRC sought an order from the Upper Tribunal to set aside the order at [40] of the FTT's decision requiring HMRC to allege a dishonest state of mind to support a case that the appellant knew that its transactions were connected with fraud.

Procedural developments

36. Since the decisions which are the subject of these appeals were released, amended SOCs have been filed in respect of each of the appeals before the FTT.

The E Buyer appeal

37. On 12 December 2014 HMRC filed an amended consolidated SOC. The provisions quoted at [6] and [7] above have not changed substantially in the amended version.

38. The amended SOC, in common with the original version, contains a headnote to the effect that full particulars of HMRC's case will be provided in the witness evidence to be served on their behalf. That witness evidence has now been served; 52 witness statements have been served on behalf of officers dealing with the alleged defaulters.

39. E Buyer contends that this material does not cure what it contends are the deficiencies in the SOC and that in the absence of a proper pleading it is unclear to it whether the allegations made in the witness evidence against defaulters and other parties in the transaction chain are relevant to the case against E Buyer and, if so, how. Neither, E Buyer contends, is it apparent from this material to what extent HMRC allege that E Buyer knew about the alleged wrongdoing by other parties, although Officer Pabari's witness statement contains the following conclusion regarding the transaction chains in which E Buyer was involved:

> "Having examined all the records available to me I have concluded that the transactions chains as a whole were contrived and did not occur through normal commercial trading between traders operating at arms length from each other."

Officer Pabari's witness statement also contains the following conclusion as to E Buyer's knowledge of the connection to fraud:

> "I have reached the conclusion that the Appellant actually knew, or in the alternative should have known that its transactions were connected with the fraudulent evasion of VAT, as summarised in the points below:
>
> (i) The Appellant was given extensive knowledge of MTIC fraud before and during the period of tax losses;
>
> (ii) The vast majority of the transactions lead to default/ hijack and contra traders;
>
> (iii) The Appellant did not keep a record of serial or unique identification of the goods despite being served a Notice of Direction to do so;
>
> (iv) The Appellant ceased these export deals well before any decisions had been issued by HMRC, lending support to the conclusion that the Appellant must have known that these transactions were linked to fraud;
>
> (v) The Appellant's trading methods and procedures for the rest of its business were not replicated for the wholesale export deals. The Appellant found itself trading with small or medium-sized entities, many of which have been in existence for a short period of time and which are no longer trading now;
>
> (vi) The goods that the Appellant traded in its B2B operation did not include those that are covered by the reverse charging legislation;
>
> (vii) Most of the entities that the Appellant traded with can be shown to have links to MTIC activity;
>
> (viii) The acceptance that detailed due diligence checks on suppliers were not undertaken before September 2010 is very surprising given that the Appellant had

commenced B2B wholesale export well before this date and had identified a suspicious supply of goods as early as March 2010;

(ix) There are a significant number of individuals within the transaction chains and freight companies that have had significant action taken against them for MTIC related issues;

(x) There are several examples of goods being recirculated within the EU as detailed in paragraphs 459-463."

40. Consequently, E Buyer continues to contend that its request for further and better particulars of the SOC is justified. We were given a replacement request which reduces the number of requests originally made.

41. In particular, HMRC are requested to provide detailed information in respect of every transaction as to the facts and matters relied upon in support of the case that E Buyer knew that its transactions were connected with fraud. Specific requests are also made regarding the adverse information contained in the SOC regarding E Buyer's customers and suppliers and, in particular, whether it is HMRC's case that E Buyer knew or ought to have known of such facts or matters.

The Citibank appeal

42. On 23 December 2014, prior to making its application for permission to appeal, HMRC filed an amended SOC which was stated to be served as a result of the FTT's decision. The amendments dealt with all of what the FTT had found to be deficiencies in the original SOC. In particular the amended SOC contains a clear statement that a dishonest state of mind is alleged against Citibank.

43. We were told that Citibank is content with the amended SOC. Mr Conlon QC, who appeared for Citibank, said that in the light of the amendments having been made Citibank regarded HMRC's appeal as "academic". That does not appear to be the case, however, as Mr Kinnear QC, who appeared for HMRC in the Citibank appeal, made it clear that if their appeal was successful HMRC would seek permission to file a further amended SOC to remove the amendments made as a consequence of the FTT's decision.

The authorities and the legal principles to be applied

44. We were referred by counsel to a large number of authorities. They largely fell into two categories: the principles applicable as a matter of ordinary English law where allegations of fraud and dishonesty are made; and the authorities on the *Kittel* principle as developed by the European court (formerly the Court of Justice of the European Communities and now the Court of Justice of the European Union, which we will refer to as the Court of Justice).

Allegations of fraud or dishonesty – the English law principles.

45. We take these first as there was little dispute about them. They are helpfully

summarised in the skeleton argument of Mr Wardell QC, who appeared for E Buyer. First it is well established that in ordinary civil litigation fraud must be distinctly alleged (and distinctly proved, although we are not concerned with that at this stage): see *Armitage v Nurse* [1998] Ch 241 at 256F per Millett LJ:

> "The general principle is well known. Fraud must be distinctly alleged and as distinctly proved: *Davy v. Garrett* (1878) 7 Ch.D. 473, 489, *per* Thesiger L.J. It is not necessary to use the word "fraud" or "dishonesty" if the facts which make the conduct complained of fraudulent are pleaded; but, if the facts pleaded are consistent with innocence, then it is not open to the court to find fraud. As Buckley L.J. said in *Belmont Finance Corporation Ltd. v. Williams Furniture Ltd.* [1979] Ch. 250, 268:
>
> > "An allegation of dishonesty must be pleaded clearly and with particularity. That is laid down by the rules and it is a well-recognised rule of practice. This does not import that the word 'fraud' or the word 'dishonesty' must be necessarily used . . . The facts alleged may sufficiently demonstrate that dishonesty is allegedly involved, but where the facts are complicated this may not be so clear, and in such a case it is incumbent upon the pleader to make it clear when dishonesty is alleged."

As this passage also demonstrates the requirement applies equally to allegations of dishonesty as it does to allegations of fraud.

46. Second, an allegation of fraud or dishonesty must not only be distinctly alleged but sufficiently particularised. This is a separate principle. The requirement to plead fraud or dishonesty unequivocally is designed to give the party opposite sufficient notice that this is indeed what is being alleged. The requirement to give sufficient particulars goes further than this: see *Three Rivers District Council v Governor and Company of the Bank of England (No 3)* [2003] 2 AC 1 at [186] per Lord Millett:

> "This is only partly a matter of pleading. It is also a matter of substance. As I have said, the defendant is entitled to know the case he has to meet. But since dishonesty is usually a matter of inference from primary facts, this involves knowing not only that he is alleged to have acted dishonestly, but also the primary facts which will be relied upon at trial to justify the inference. At trial the court will not normally allow proof of primary facts which have not been pleaded, and will not do so in a case of fraud. It is not open to the court to infer dishonesty from facts which have not been pleaded, or from facts which have been pleaded but are consistent with honesty. There must be *some* fact which tilts the balance and justifies an inference of dishonesty, and this fact must be both pleaded and proved."

47. Third, these principles apply just as much in tax appeals heard in the FTT as they do in other litigation: see *Blue Sphere Global Ltd v HMRC* [2008] UKVAT 20694 at [30] per Judge Wallace:

> "It is a long established principle of English law that any allegation of fraud must be clearly pleaded with particulars. This applies to civil as well as to criminal proceedings. It applies to tax appeals just as much as to any other litigation."

See also *HMRC v Noel Dempster* [2008] EWHC 63 (Ch) at [26] per Briggs J, which was primarily concerned with the related principle that an allegation of dishonesty

made against a person called as a witness must be fairly and squarely put in cross examination, but where Briggs J also referred to the requirement that such an allegation must be fairly and squarely pleaded; and *HMRC v Sunico & others* [2012] EWHC 4156 (Ch) at [8] per Warren J.

48. Mr Puzey, who appeared for HMRC in the E Buyer appeal, did not dispute that a party pleading fraud is required to plead that allegation fairly and squarely. But he disputed that the allegation against E Buyer was one of fraud or knowing participation in a conspiracy itself. In common with Mr Kinnear, his overarching submission was that the test in *Kittel* (*Kittel v Belgium, Belgium v Recolta Recycling SRPL* (Cases C-439/04 and 440/04) [2008] STC 1537) does not require any consideration of a common law test of dishonesty in relation to the taxable person whose right to deduct input VAT has been denied; and that because HMRC do not have to prove dishonesty in a *Kittel* case, they do not have to plead it.

49. This submission requires us to consider the history of the *Kittel* principle as it has been developed both by the Court of Justice and English courts.

The Kittel principle – the European cases

50. The starting point is the decision of the Court of Justice in *Halifax plc v Customs and Excise Commissioners* (Case C-255/02) [2006] STC 919. This was not a case of MTIC fraud, or of fraud at all, but a case where the Commissioners asserted that certain transactions had been undertaken solely for the purpose of tax avoidance. The questions referred to the Court of Justice included the question whether such transactions (those effected by the participators with the intention solely of obtaining a tax advantage and which had no independent business purpose) qualified for VAT as supplies made in the course of the participators' economic activities. The Court of Justice held that the concepts of economic activities and supplies were objective in character and had to be assessed without regard to the purpose of the transactions, so that such transactions were supplies of goods of services and economic activities provided they satisfied such objective criteria (at [55]-[58]). They continued (at [59]):

> "It is true that those criteria are not satisfied where tax is evaded, for example by means of untruthful tax returns or the issue of improper invoices."

The effect of this finding is that where the tax is evaded by the taxable person himself the requirements of there being a supply of goods by the taxable person acting as such and the carrying on of an economic activity will not be met and there will be no right to deduct input tax in relation to the transactions concerned. We refer to this finding in this decision as the "*Halifax* principle".

51. The next relevant case is *Optigen Ltd, Fulcrum Ltd and Bond House Systems Ltd v Commissioners of Customs & Excise* (Cases C-354/03, C-355/03 and C-484/03) [2006] ECR I-483. These were cases where the Commissioners alleged that the taxpayers' transactions formed part of a chain of supply which involved a defaulting trader in a carousel fraud but where the Commissioners did not suggest that the taxpayers themselves were aware of the fraud. The Commissioners' argument was that this meant that the transactions were not supplies in the course of an economic

activity. That was rejected by the Court of Justice who held (at [55]) that such transactions, not themselves vitiated by VAT fraud, constituted supplies of goods or services and an economic activity where they fulfilled the relevant objective criteria, regardless of the possible fraudulent nature of another transaction, prior or subsequent, in the chain of supply of which the taxable person had no knowledge and no means of knowledge.

52. These two cases, *Halifax* and *Optigen*, can be seen as marking the outer limits of the effect of fraud on the right to deduct or reclaim VAT: if the taxpayer is himself seeking to evade tax, his fraudulent transaction does not meet the objective criteria to qualify as a supply of goods and he has no right to deduct (*Halifax*); but if the taxpayer's own transaction is not vitiated by fraud in this way, and he has no knowledge and no means of knowledge of a fraud by someone else elsewhere in the supply chain he cannot be denied the right to deduct.

53. Those cases did not deal with the situation where the taxpayer was not himself seeking to evade tax but did have knowledge or means of knowledge of a fraud by someone else. That was the issue resolved by the Court of Justice in *Kittel* itself. The facts of the two cases in which a reference was made were rather different. In the first case, the Belgian tax authorities had decided that the taxpayer (a company called Ang Computime Belgium, of which Mr Kittel was the receiver) had knowingly participated in a carousel fraud and that the supplies effected to it were fictitious (see at [10]). In the second case, by contrast, the taxpayer, Recolta, had bought some luxury vehicles from a Mr Ailliaud; the tax authorities concluded that Mr Ailliaud, who did not account for the output VAT paid to him by Recolta, had set up a carousel fraud of which the Recolta transaction formed part, but there was nothing to suggest that Recolta and its directors knew or had any suspicion that they were involved in a major fraud scheme (see at [14]-[17]). Under Belgian law, a contract intended to defraud a third party was incurably void, it being enough that one party had contracted for unlawful purposes and it was not necessary for the other party to the contract to know of those purposes (see at [22]). In these circumstances, the questions asked of the Court of Justice were effectively (1) whether a purchaser of goods who had entered into a contract in good faith without knowledge of a fraud committed by the seller could be denied the right to deduct input tax (on the grounds that the contract was incurably void); (2) whether it made any difference that the contract was incurably void for fraudulent evasion of VAT itself; and (3) whether it made any difference if the fraudulent evasion of VAT was known to both parties (see at [25]).

54. The Court of Justice, considering the questions together, reiterated, as decided in *Optigen*, that a taxable person who entered into transactions, not themselves vitiated by VAT fraud, could not have his right to deduct input tax affected by the fact that another transaction in the same chain of supply was vitiated by VAT fraud without that taxable person "knowing or having any means of knowing" (at [45]); and said that the same applied where the seller was committing a fraud without the taxable person "knowing or having any means of knowing" (at [46]). That led to the conclusion that traders "who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud" must be able to rely on the legality of the transactions without the risk of losing their right

to deduct the input VAT (at [51]) and hence:

> "52. It follows 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."

55. The Court then reiterated, as it had said in *Halifax*, that where tax was evaded by the taxable person himself, the objective criteria for supply of goods and economic activity were not met; Community law could not be relied on for abusive or fraudulent ends; if the right to deduct had been exercised fraudulently, tax authorities could claim repayment; and if the right to deduct was being relied on for fraudulent ends, it could be denied (at [53]-[55]).

56. They then turned to what has become known as the *Kittel* principle, as follows:

> "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'."

They then reiterated what they had said at [52] in relation to a taxpayer who "did not and could not know" that the transaction concerned was connected with a fraud committed by the seller, and concluded:

> "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."

57. Before coming to the later authorities, we will give our own views of what can be taken from this decision. First, the Court of Justice was concerned to lay down a

clear line between those who do not, and those who do, lose their right to deduct input tax. That line is drawn between those who come within the *Optigen* principle – variously expressed as applying where a taxpayer "had no knowledge and no means of knowledge" of the possible fraudulent nature of another transaction in the chain of supply ([44]); or where a prior or later transaction is vitiated by fraud, or the seller himself is committing fraud, without the taxpayer "knowing or having any means of knowing" ([45]-[46]); or the taxable person "did not and could not know" that the transaction concerned was connected with a fraud committed by the seller ([52], [60]) – and those who by contrast come within the *Kittel* principle, repeatedly identified as those who "knew or should have known" that they were taking part in, or participating in, a transaction connected with a fraudulent evasion of VAT ([56], [58], [61]). We will call this class of taxable persons "the *Kittel* class".

58. Second, as these citations show, the line was expressed by the Court of Justice in terms of knowledge. As Mr Kinnear said, the word "dishonesty" does not feature in the judgment. This is perhaps unsurprising given the questions that were asked, but we certainly accept that the Court of Justice did not express its conclusions in terms of dishonesty. And it would have been quite odd if it had, given that the Court of Justice included within the *Kittel* class those who "should have known" of the connection: someone who should have known that his transaction was connected to a fraud, but did not in fact, would not in any usual sense of the term be regarded as dishonest. Having included those who should have known, as well as those who knew, within this class, there is no particular reason why the Court should have said anything about the honesty of the *Kittel* class as a whole.

59. Third, on the other hand, the Court of Justice held that a person in the *Kittel* class should be "regarded as a participant in the fraud" ([56]) who "aids the perpetrators of the fraud and becomes their accomplice" ([57]). This is the basis on which the *Kittel* class is denied the right to deduct – they are equated for VAT purposes with those who evade tax themselves (see the opening words of [56]: "In the same way…").

60. Fourth, there are two limbs to the *Kittel* principle, namely that the *Kittel* class includes both those who have actual knowledge of the connection to fraud and those who should have known. The Court of Justice does not distinguish between them in any of its remarks, nor, as we have said, does it say anything in terms about the honesty or otherwise of the *Kittel* class, but in the case of those who come within the first limb, that of actual knowledge, it may perhaps be doubted whether the Court would have regarded their knowing participation in a transaction connected with fraud such that they must be regarded as participants in a fraud, or as knowing accomplices to and aiding fraud, as consistent with honesty.

61. In summary therefore, *Kittel* laid down at the European level a test of "knew or should have known"; this is plainly not an honesty test, and the word "dishonesty" does not feature in the judgment; but this does not answer what we regard as the real question in these appeals which is whether, in a case where HMRC choose to allege actual knowledge of a fraud under what we have called the first limb of *Kittel*, such an allegation is tantamount to, or attracts the same consequences in domestic law as, an

allegation of dishonesty. This is the point we come back to below.

62. The only subsequent decision of the Court of Justice to which we were referred was *Bonik EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na ispalnenieto' – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (case C-285/11) [2013] STC 773, a decision on a reference from Bulgaria. The Court of Justice reiterated the *Halifax* principle which applied where a tax fraud is committed by the taxpayer himself (at [38]); the *Kittel* principle which applied "by the same token…" where a taxable person knew or should have known that by his purchase he was taking part in a transaction connected with VAT fraud (at [39]); and the *Optigen* principle under which a penalty could not be imposed on a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud by the supplier or that another transaction in the same chain of supply was vitiated with fraud (at [41]).

63. We do not read *Bonik* as laying down any significant new principle, although it reiterates that the question whether a person comes within the *Kittel* class (that is whether he knew or should have known) is to be ascertained having regard to objective factors (at [40]), and makes the point that it is for the tax authorities to establish, "to the requisite legal standard", the objective evidence needed to substantiate this conclusion (at [43]). The reference to "the requisite legal standard" is, as we accept, a reference to the standard of proof required by national law: as Advocate General Colomer said in his Opinion in *Kittel*, it is for the national court to determine the existence of the requisite elements in accordance with the rules of national law (so long as the effectiveness of Community Law is not thereby undermined): Opinion at [57].

The Kittel principle – the English authorities

64. The first relevant English authority discussing the *Kittel* principle to which we were referred is the decision of Lewison J in *Revenue & Customs Commissioners v Livewire Telecom, Revenue & Customs Commissioners v Olympia Technology Ltd* [2009] EWHC 15 (Ch). As always it is important to read the statements of principle in the judgment against the background of the particular facts of the case. Lewison J had before him appeals in two cases from decisions of the Value Added Tax and Duties Tribunal. He summarised the essential question as follows:

> "3 In essence the question of law is: in what circumstances may HMRC lawfully refuse to make a payment of input VAT to an exporter who is not himself dishonest and does not have actual knowledge of a scheme to defraud the Revenue? The question has to be put in that way because the Tribunal in each case found as a fact that the taxable person was not dishonest and had no actual knowledge of such a scheme. HMRC cannot appeal against that finding of fact."

65. Lewison J first decided that HMRC could in each case rely on the second limb of *Kittel*: in the *Livewire* case, HMRC had put its case to the Tribunal on both limbs of *Kittel* (at [27]), and in the *Olympia* case, HMRC's case was put on the basis that Olympia ought to have known of the fraud (at [38]). This background is significant because it makes it clear that in the High Court HMRC was no longer seeking in

either appeal to rely on the first limb of *Kittel*, but only on the second limb.

66. That is the context in which Lewison J, in an extended passage at [84]-[88], considered and rejected a submission on behalf of both taxpayers that the Court of Justice was laying down a test of dishonesty. It is not necessary to cite it all: it is sufficient to refer by way of example to the following extracts from [85]:

> "…it seems to me that the ECJ was at pains to stress that the test was not one of dishonesty…A requirement to take all reasonable precautions … is incompatible with a simple test of dishonesty … In addition, it seems to me that the proposition that whether a person knew or should have known is to be tested by objective facts or factors … is also inconsistent with a simple test of dishonesty."

Mr Kinnear submitted that Lewison J's judgment in relation to the lack of a dishonesty requirement in a *Kittel* case had not been considered by another court or tribunal of co-ordinate jurisdiction, remained good law and should be followed unless we thought it plainly wrong. We certainly do not think it plainly wrong; on the contrary it seems to us to be plainly right. But we do not think it has the significance that Mr Kinnear sought to attach to it. As the facts show, by the time the cases reached the High Court, HMRC had failed to establish actual knowledge on the part of the taxpayers within the first limb of *Kittel*, and were reliant on showing that the taxpayers "should have known" within the second limb. It seems to us self-evident that an allegation that a taxpayer should have known (although he did not in fact know) that his transaction was connected to a fraud is not an allegation of dishonesty. But this tells one nothing about a case where HMRC does rely on the first limb of actual knowledge, and nothing in Lewison J's judgment suggests that he intended to say anything about such a case, which was not the case he had to deal with.

67. The next relevant authority to refer to is the decision of Briggs J in *Megtian Ltd v HMRC* [2010] EWHC 18 (Ch). This was another appeal from the VAT and Duties Tribunal, which in this case had dismissed Megtian's appeal against HMRC's decision to disallow input tax. It did so on the grounds that Megtian knew that the relevant transactions were connected with fraud, although it also concluded by way of alternative that Megtian ought to have known. One of the grounds of Megtian's appeal to the High Court was that the Tribunal's conclusion that Megtian knew that each of its deals was connected with fraud, and its conclusion (in the alternative) that Megtian ought to have known, were each contrary to the evidence. One of the arguments advanced on behalf of Megtian was that it was not open to the Tribunal to find that Megtian knew (rather than merely ought to have known) of the connection, because an allegation of knowledge did not with sufficient clarity form part of HMRC's case before the Tribunal (see at [40]).

68. Briggs J in the result rejected that contention, being satisfied that from start to finish HMRC advanced a case that Megtian actually knew that its transactions were connected with fraud, as well as the alternative case that it ought to have known (at [49]). That conclusion of course turned on its own facts, but in the course of discussing this ground of appeal Briggs J said:

> "41 It is important to bear in mind, although the phrase "knew or ought to have

> known" slips easily off the tongue, that when applied for the purpose of identifying the state of mind of a person who has participated in a transaction which is in fact connected with a fraud, it encompasses two very different states of mind. A person who knows that a transaction in which he participates is connected with fraudulent tax evasion is a participant in that fraud. That person has a dishonest state of mind. By contrast, a person who merely ought to have known of the relevant connection is not dishonest, but has a state of mind broadly equivalent to negligence.
>
> 42 The distinction between dishonesty and negligence is of fundamental importance, even in cases such as the present where proof of either of them will suffice for the opposing party's purpose. For that reason, an allegation of dishonesty in civil litigation must be clearly and specifically pleaded, and, if the person against whom dishonesty is alleged gives oral evidence, it must be specifically put in cross-examination. These principles apply to all civil litigation, including tax appeals: see for example *Revenue and Customs Commissioners v Noel Dempster* [2008] EWHC 63 (Ch)."

69. Mr Kinnear submitted that Briggs J was wrong in [41] to equate the knowledge required for the first limb of *Kittel* with dishonesty, and the state of mind required for the second limb of *Kittel* with negligence. He said that dishonesty and negligence were English common law concepts. He suggested that although Lewison J's judgment in *Livewire* was before Briggs J, his attention does not appear to have been drawn to [84]-[85] where Lewison J rejected the submission that the Court of Justice in *Kittel* was laying down a test of dishonesty. He also suggested that what Briggs J said in [41] could not stand in the light of the judgment of Moses LJ in the later case of *Mobilx Ltd v Revenue and Customs Commissioners* [2010] EWCA Civ 517.

70. We will consider *Mobilx* shortly. But we reject the idea that there is anything in what Briggs J said that is inconsistent with what Lewison J had said in *Livewire*, or that suggests that he was unaware of the relevant passage. Lewison J, as we have sought to explain, was not considering the first limb of *Kittel*, but the second limb; and his conclusion that dishonesty was not required for the second limb says nothing at all about the effect of an allegation of knowledge within the first limb.

71. Nor do we think that Briggs J was concerned with the technicalities of the common law concepts of dishonesty and negligence – indeed so far as the second limb is concerned, he specifically referred to the second limb as "broadly equivalent to negligence", not as mapping it precisely. Equally there is no reason to think that in referring to the first limb as connoting dishonesty he was intending to suggest that it precisely mapped the common law concept of dishonesty. As the decided cases show, this can be a matter of some technicality on which refined arguments are possible: compare for example the judgments in *Twinsectra Ltd v Yardley* [2002] UKHL 12 and *Barlow Clowes International Ltd v Eurotrust International Ltd* [2005] UKPC 37. It cannot of course be supposed that the Court of Justice, which is a European court dealing with European law, had in mind the precise parameters of the common law concept of dishonesty; and there is no reason to think that Briggs J fell into the mistake of thinking that it did.

72. Rather, as we read this part of his judgment, he was making a broader point,

which is that the rolled-up plea of "knew or ought to have known" conceals two very different states of mind, there being a significant difference between accusing someone of knowing that his transaction is connected with fraudulent tax evasion, and merely alleging that they ought to have known. The former, which he characterised as involving a dishonest state of mind, requires to be clearly and specifically pleaded and specifically put in cross-examination. This is all preparatory to his examination of the question whether on the facts before him HMRC's case before the Tribunal was clearly based on the first limb of *Kittel* as well as the second. As already mentioned, he concluded that it was, but it is of some interest how he expresses his conclusion, namely:

> "49 Those references demonstrated to me that, from start to finish, HMRC advanced a case that Megtian knew that the transactions upon which it based its input tax claims were connected with tax fraud, and a case in the alternative that, if it did not know of the connection, it ought so to have known. Indeed, my reading of those materials is that HMRC's primary case was that, from start to finish, Megtian was a knowing participant in a contrived, pre-ordained series of transactions designed to achieve the evasion of tax rather than, as Mr Andreou maintained in his evidence (and upon which he was disbelieved) that those transactions were separate arm's length commercial deals negotiated with individual and independent traders in a competitive fast-moving market.
>
> 50 Mr Patchett-Joyce frankly and very properly acknowledged (so as to avoid a time consuming trawl through the transcript of the lengthy cross-examination of Mr Andreou) that a case that Megtian knew that the relevant transactions were connected with tax fraud, in the sense which I have just described, was properly put by way of cross-examination…"

It can be seen that what he concludes is that HMRC did advance a case that Megtian "knew that the transactions … were connected with tax fraud", and that the case that Megtian knew this was properly put in cross-examination. In other words, Briggs J was not saying that in a case brought under the first limb of *Kittel*, what HMRC needed to allege in terms, and put to a witness in terms, was that the taxpayer had acted "dishonestly". What he was saying was that where HMRC advanced a case under the first limb, they needed to make it clear, with sufficient particularity, and to put in cross-examination, the allegation that the taxpayer actually knew that the relevant transactions were connected with tax fraud; and that this was because to allege such a thing was in effect to allege a dishonest state of mind and attracted the usual consequences of making such an allegation.

73. Mr Kinnear submitted that it was not the case that every taxpayer who knew that his transaction was connected with fraud was dishonest. He gave an example of a taxpayer who purchases goods from a seller who tells him that he is not going to account for the VAT. Such a purchaser, he said, would be within the first limb of *Kittel* (as he would know that his transaction was connected with tax fraud) but would not himself be dishonest. We think there would be room for debate on the latter proposition – dishonesty depends among other things on whether what the relevant person did was contrary to normally acceptable standards of honest conduct, and it might be thought that buying goods from someone who by his own confession

intended to defraud HMRC of the tax due was not the way in which honest people behave – but we do not regard it as necessary to resolve this question. It was common ground before us that not all cases where knowledge within the first limb of *Kittel* is alleged amount to an allegation of dishonesty: Mr Wardell accepted that he was not saying that knowledge within the first limb of *Kittel* was always equivalent to dishonesty; and Mr Conlon said that whether or not the taxpayer's knowledge involves dishonesty as a matter of English law will depend on the facts and circumstances alleged by HMRC.

74. But we do not read Briggs J as seeking to lay down a universal rule that every conceivable case of knowing connection within the first limb of *Kittel* would necessarily meet the common law test of dishonesty. On the facts of the case before him HMRC alleged that Megtian was a knowing participant in a contrived, pre-ordained series of transactions designed to achieve the evasion of tax, which plainly was an allegation of conduct that was dishonest; and we suspect that in very many cases where HMRC advance a case under the first limb of *Kittel*, it will be quite plain that if the taxpayer is guilty of the conduct alleged, he will have been acting dishonestly by any standards.

75. The next relevant decision is that of the Court of Appeal in *Mobilx*. This was the conjoined hearing of three appeals (*Mobilx*, *Blue Sphere Global Ltd*, and *Calltel Telecom Ltd*), which were the first appeals in this area to reach the Court of Appeal after *Kittel*. Again it is important to look at the particular facts in each case to understand what the issues were. These were different in each of the three appeals.

76. Taking *Calltel* first, the Tribunal had found that the transactions in which Calltel, and an associated company called Opto Telelinks (Europe) Ltd, were involved were nothing more than a device to cheat the taxing authorities in the UK and elsewhere, and that Mr Gohir, the owner and controller of both companies, was "well aware that the appellants were dealing in goods which were being used as the instrument of fraud" (see at [6]). An appeal to the High Court was dismissed by Floyd J who concluded that the Tribunal was entitled to make a finding of actual knowledge (see at [8]). Moses LJ, who gave the only reasoned judgment in the Court of Appeal, commented that "Accordingly, it can be seen that Calltel is a paradigm of a case where the traders knew of the connection between the transactions in which they were involved and VAT fraud" (at [8]). When he returned to the facts of the appeals (after considering the various challenges put forward by the taxpayers to the application of the *Kittel* principle), he dealt with the facts in *Calltel* very briefly, simply saying (at [67]):

> "There can be no question of a second challenge to the findings of actual knowledge in *Calltel* and *Opto*."

Calltel therefore is an example of a case where by the time it reached the Court of Appeal, the finding of fact by the Tribunal that the taxpayers had actual knowledge, within the first limb of *Kittel*, that their transactions were connected with VAT fraud was unassailable. It is not surprising in those circumstances that the judgment of Moses LJ contains little or no discussion of the first limb. What he is concerned to do

is not to explore what the first limb requires, but decide whether the particular challenges to the application of the *Kittel* principle (see below) were sound or not.

77. The other two appeals did not concern the first limb of *Kittel* at all as in neither case was it established that the taxpayer knew of a connection between its transactions and VAT fraud (see at [9]). In *Blue Sphere Global*, the Tribunal found that the company's sole director and shareholder would have concluded, had he asked appropriate questions, that the most probable explanation was that its transactions were connected with fraud, but in the High Court Sir Andrew Morritt C allowed an appeal on the basis that it was not enough that the company ought to have appreciated that there was a risk that its transactions were connected with fraud; it was necessary to prove that it ought to have known that it *was* participating in transactions connected with a fraudulent evasion of VAT (see at [11]). By contrast, in *Mobilx*, where the Tribunal concluded that it should have been apparent to Mobilx that its transactions were more likely than not to be connected to fraud, Floyd J dismissed an appeal on the basis that this was sufficient to deny Mobilx the right to deduct input tax (see at [14]-[15]). These two cases therefore raised the question of what precisely sufficed to bring a case within the second limb of *Kittel*; neither however raised any issue about the first limb.

78. There were, so far as appears from the report, five main challenges put forward by the taxpayers: (i) that the *Kittel* principle could not be applied in the UK without specific legislation (see [45]-[49]); (ii) that there had been a misunderstanding of what was required before it could be said a trader "should have known" within the second limb of *Kittel* (see [50]-[52]); (iii) that it was not enough to show that a trader knew or should have known that it was more likely than not that his transaction was connected to fraud (see [53]-[60]); (iv) that the application of the *Kittel* principle infringed the principle of legal certainty (see [61]-[62]); and (v) that the *Kittel* principle involved the imposition of a penalty in contravention of Article 1 of the First Protocol to the European Convention on Human Rights (see [63]-[65]). There may also have been challenges based on the principles of fiscal neutrality, free movement of goods and proportionality, which are briefly mentioned in [66], but there is no extended discussion of any of these.

79. In the event Moses LJ rejected all of these challenges except (iii) where he accepted that what must be established is that the trader knew or should have known that by his purchase he *was* taking part in a transaction connected with fraud (at [56]). It can be seen that none of them raise any question as to the precise ambit of the first limb; far less do they involve any discussion as to whether conduct within the first limb does or does not involve "dishonesty", a word which does not feature in the judgment.

80. Mr Kinnear referred us to two passages in the judgment of Moses LJ in particular. One was at [41] where Moses LJ said as follows:

> "41 In *Kittel* after §55 the Court developed its established principles in relation to fraudulent evasion. It extended the principle, that the objective criteria are not met where tax is evaded, beyond evasion by the taxable person himself to the position of

> those who knew or should have known that by their purchase they were taking part in a transaction connected with fraudulent evasion of VAT:-
>
> [he then cited [56]-[59] of the judgment in *Kittel* and continued]
>
> The words I have emphasised "in the same way" and "therefore" link those paragraphs to the earlier paragraphs between 53–55. They demonstrate the basis for the development of the Court's approach. It extended the category of participants who fall outwith the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. *Kittel* did represent a development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct."

81. Mr Kinnear submitted that the reference to "those who themselves had no intention of committing fraud" showed that it cannot be a requirement that HMRC must prove that the taxable person in a *Kittel* case was acting fraudulently or dishonestly, as one cannot have no intention of committing fraud and yet be dishonest. This does not seem to us to be what Moses LJ was here saying. As we read Moses LJ's judgment, all he meant was that the Court of Justice had previously (in *Halifax*) dealt with the case where the taxable person evaded or intended to evade tax himself, for example by failing to account for tax that was due from him; and then (in *Kittel*) extended the same treatment to others who did not themselves intend to evade their own tax, but who were to be treated as participants in the fraud. There is here no warrant for reading Moses LJ as saying anything about whether persons treated as participants in this way would or would not be dishonest, a question that was not raised before him and was not relevant to the issue he was discussing. Whether such a person would be dishonest would depend on the facts. A person within the *Kittel* class might have no intention of himself defaulting on any tax due from him and yet be centrally involved in the scheme to defraud HMRC, and undeniably dishonest; or he might be in fact unaware of the scheme to defraud HMRC and only within the *Kittel* class because he ought to have been aware, in which case as we have already said we think it plain that he would not be dishonest. In short, we do not think what Moses LJ says in [41] can be used to resolve this question; nor for that matter do we think it undermines what Briggs J said in *Megtian*.

82. The other passage Mr Kinnear referred us to was at [59] where 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 surround their transactions that they were connected to fraudulent evasion…"

Mr Kinnear suggested that this simple *Kittel* test did not involve any reference to dishonesty. Again we think this is to take what Moses LJ said out of context. In this part of his judgment he was considering what it is that the taxpayer must be shown to have known or ought to have known, namely whether it is enough to show that he

knew or should have known that it was *more likely than not* that his transaction was connected with fraudulent evasion, or whether it had to be shown that he knew or should have known that it *was* so connected (see at [60]). He is not here saying anything about whether a person who did know that his transaction was connected to fraudulent tax evasion would or would not be dishonest.

83. As the leading decision of the Court of Appeal on the application in this jurisdiction of the *Kittel* principle, *Mobilx* is not only binding on us but contains much helpful and valuable guidance. We have read and re-read Moses LJ's judgment; but we have not cited from it extensively as, for the reasons we have sought to give, it does not in our view determine the outcome of these appeals, nor does it really address the questions which arise.

84. We were also referred to the decision of the Court of Appeal in *Fonecomp Ltd v Commissioners for Revenue and Customs* [2015] EWCA Civ 39. Two grounds were argued on the appeal: the first was that the *Kittel* principle only applied where fraudulent evasion of VAT occurred in the same chain of supply as the taxpayer's transaction; the second was (effectively) that Fonecomp did not know the details of the fraud or the precise connection between its purchases and the fraudulent evasion of VAT. Arden LJ, who gave the only reasoned judgment, rejected both grounds. In connection with the second ground she said:

> "45 The CJEU determined in Kittel that knowledge was the essential characteristic of a participant in a fraud who lost his right of deduction. The type of knowledge required is not necessarily derived from any national law test, still less common law fraud but has been devised by the CJEU: see generally Case 296/95 *R (o/a EMU Tabac SARL) v Comrs of Customs & Excise* [1998] ECR 1–1605 at [30]."

85. The reference to the *EMU Tabac* case at [30] is to a statement by the Court of Justice that:

> "the Community legal order does not, in principle, aim to define concepts on the basis of one or more national legal systems unless there is express provision to that effect."

This is by now a well-established principle of European law, and we have already said that the Court of Justice cannot be supposed to have had common law concepts of fraud in mind in *Kittel*. Mr Kinnear submitted that Arden LJ here effectively ruled out consideration of dishonesty as part of the *Kittel* test. We agree, as we have already said, that the test laid down in *Kittel* is one of knowledge, not of dishonesty; it is certainly not to be regarded as synonymous with dishonesty as understood by the common law. But again we do not regard this as the real question, which is whether in a case where HMRC choose to allege actual knowledge of a fraud under the first limb of *Kittel*, such an allegation is tantamount to, or attracts the same consequences in domestic law as, an allegation of dishonesty.

86. We have now considered the main authorities cited to us on the *Kittel* principle, including all the relevant decisions of the Court of Justice or Court of Appeal. Our conclusions from the review of these authorities are as follows:

(1) The Court of Justice in *Kittel* did not lay down a test of dishonesty but of knowledge, or to be more specific whether the taxpayer knew or should have known that he was taking part in a transaction connected with fraudulent evasion of VAT.

(2) Ultimately the question in every *Kittel* case is whether HMRC has established that that test has been met. The test is to be applied in accordance with the guidance given by the Court of Appeal in *Mobilx* and *Fonecomp*.

(3) It is certainly possible for that test to be satisfied without the taxpayer being dishonest. This is likely to be the case for example where HMRC rely exclusively on the second limb of *Kittel* as (by the time the appeal reached the High Court) they did in *Livewire*: see *Livewire* at [84]-[85] per Lewison J.

(4) On the other hand where HMRC rely on the first limb of *Kittel* and allege that the taxpayer actually knew that he was taking part in a transaction connected with fraudulent evasion of VAT, this will very often amount to an accusation of conduct that would be regarded as dishonest by an English court: see *Megtian* at [41] per Briggs J.

(5) It does not necessarily follow that all cases of actual knowledge within the first limb of *Kittel* allege conduct that would be regarded as dishonest by an English court, and there may be cases where the taxpayer satisfies the first limb of *Kittel* but would nevertheless not be regarded as dishonest. As we have said above, this was in fact common ground between the parties.

(6) But whether the case advanced by HMRC in any particular case does or does not allege conduct that would be regarded as dishonest does not turn on whether they choose to allege that the taxpayer is himself evading tax under the *Halifax* principle or has knowledge that his transaction is connected with fraudulent evasion by someone else under the *Kittel* principle; it turns on what HMRC actually allege in each particular case.

87. We add a few comments on the last point. Some of Mr Kinnear's submissions seemed to us to amount to saying that there was a distinction between (i) a case where HMRC alleged that the taxpayer was himself party to a fraud and dishonest under the *Halifax* principle and (ii) a case where HMRC chose to make no such allegation but to proceed under the first limb of the *Kittel* principle, in which case all that they had to allege and prove was knowledge, and it followed that they were not accusing the taxpayer of dishonesty at all. This seems to us to be a false dichotomy. As we understand the Court of Justice in *Kittel*, the distinction between the *Halifax* principle and the *Kittel* principle is not that one applies to dishonest conspirators in a fraud and the other to those who "merely" know of a connection; but that the *Halifax* principle applies to those who are evading their own tax (and operates by denying their transactions the status of a "supply of goods" and "economic activity" within the meaning of the VAT Directive), whereas the *Kittel* principle applies to those who know (or should have known) that their transactions are connected to such evasion. This latter class, the *Kittel* class, are not evading their own tax but are treated as participants in the fraudulent evasion with the result that their own transactions, even though otherwise meeting the objective criteria for supply of goods, are also denied that status. The *Kittel* class, as we have said, may include both those who are

dishonest and those who are not; whether in any particular case HMRC are alleging dishonesty against a taxpayer therefore does not depend on whether HMRC have brought the case under the *Halifax* principle or the *Kittel* principle, but on what HMRC allege the facts to be in the particular case.

88. Mr Kinnear also referred us to *Universal Enterprises (EU) Ltd v HMRC* [2015] UKUT 311 (TCC), a decision of the Upper Tribunal dismissing an appeal from the FTT which had disallowed Universal's claim to deduct input tax on the grounds that Universal's directing mind, Mr Sodha, knew that its transactions were connected with fraud. Among other grounds of appeal advanced by Universal was one (Ground 4) that HMRC had failed to plead a case in fraud against Universal (see [91]). HMRC's response was that they did not need to plead that Universal was a party to fraud or conspiracy (at [92]). The Upper Tribunal agreed, saying:

> "100 In our view HMRC pleaded the matter appropriately, and it is apparent that Universal fully understood the case that it had to meet, recognising that the burden of proof lay with HMRC. In particular, what was pleaded required HMRC to satisfy the *Kittel* test. It may be that evidence to suggest that Universal was itself a participant in the fraud or that it was engaged in a conspiracy would ensure that the Kittel test was met. The *Kittel* principle is, however, a principle of the EU VAT system and we do not consider that it requires HMRC to plead either fraud or conspiracy as part of their case."

We do not regard this as inconsistent with the views we have expressed above. We agree that it is not necessary, in order for HMRC to bring a case within the first limb of the *Kittel* principle, that HMRC allege in terms that the taxpayer is itself party to a conspiracy to defraud; what needs to be pleaded is knowledge of a connection with fraud. In a case where such knowledge was pleaded against Universal, and Universal understood the case it had to meet, and was found by the FTT to have the knowledge alleged against it, it is unsurprising if the Upper Tribunal concluded that there was no pleading point available to Universal on appeal. But this does not answer whether in any particular case the allegations in fact made by HMRC do or do not amount to an allegation of dishonesty.

Application of the principles – Citibank

89. We can now apply these principles to the cases before us. We will start with the Citibank appeal. As set out above ([35]), HMRC sought an order from the Upper Tribunal setting aside the FTT's order at [40] of its decision requiring HMRC to make it clear whether or not it is alleging a dishonest state of mind against the appellant.

90. As shown by the citations from the original SOC above, HMRC alleged at [49] that "the Appellant's transactions formed part of an overall scheme to defraud the Revenue, that the scheme involved an orchestrated and contrived series of transactions, and that there were features of those transactions which demonstrate that the Appellant knew or ought to have known that this was the case." We note (1) that identical wording appears in the amended E Buyer SOC at [38], which suggests that this may be standard wording deployed by HMRC in similar cases and (2) that the reference to "the Appellant" in this paragraph may not be accurate. As explained

above, the trades were carried out by CGM, a member of Citibank's VAT group and not by Citibank itself, and in the conclusion of the SOC at [96] the allegation is, as one would expect it to be, that CGM (rather than Citibank) knew or should have known of its connection with VAT fraud.

91. We also note that in both [49] and [96] the SOC uses the rolled-up plea of "knew or ought to have known" or "knew or should have known." In the context of ordinary civil litigation there is clear Court of Appeal authority that a pleading in a form such as this does not make alternative allegations, one of knowledge, and in the alternative one that the relevant facts should have been known: see *Armitage v Nurse* [1998] Ch 241 at 257A-B per Millett LJ:

> "That case [*Belmont Finance Corporation Ltd v Williams Furniture Ltd* [1979] Ch 250] is authority for the proposition that an allegation that the defendant "knew or ought to have known" is not a clear and unequivocal allegation of actual knowledge and will not support a finding of fraud. It is not treated as making two alternative allegations, i.e. an allegation (i) that the defendant actually knew with an alternative allegation (ii) that he ought to have known; but rather a single allegation that he ought to have known (and may even have known - though it is not necessary to allege this)."

Despite this unequivocal statement, it was common ground in both cases before us that HMRC were seeking to rely on both limbs of Kittel, that is that they did make two alternative allegations, one that the taxpayers actually knew, and in the alternative that they ought to have or should have known. Since both parties in each case accepted that this was so, we will proceed on this basis, although we do not ourselves see why the principles of pleading should in this respect be any different in the FTT from what they are in the civil courts. We acknowledge of course that the Court of Justice in *Kittel* repeatedly used the composite phrase "knew or should have known", drawing no distinction between the two limbs, but as illustrated by the facts of *Livewire*, *Megtian* and *Mobilx*, there is a real difference in practice between the two limbs. Since procedure is a matter for the national court, we would have thought it preferable for HMRC, where it is proceeding under both limbs of *Kittel*, to adhere to the usual principles of pleading and make allegations of knowledge within the first limb separately from allegations in the alternative that the taxpayer should have known within the second limb.

92. Be that as it may we proceed on the basis that HMRC do allege actual knowledge in [49] of the SOC. On that basis, the allegation is that the Appellant's transactions formed part of an overall scheme to defraud the Revenue, the scheme involved an orchestrated and contrived series of transactions, and there were features of the transactions which demonstrate that the Appellant knew that "this was the case". We will assume that this is intended to level allegations against CGM rather than Citibank. Reading this together the natural meaning of the allegation is that CGM knew both that there was an overall scheme, involving an orchestrated and contrived series of transactions, to defraud the Revenue, and that its transactions were part of this scheme. Does this allegation amount to an allegation of dishonest conduct?

93. In our view it does. We do not see how a trader in the position of CGM could honestly proceed with a transaction if it knew that the transaction in question was part of an orchestrated and contrived scheme to defraud the Revenue. No argument was we think addressed to us to the effect that such conduct could be consistent with honesty.

94. When we come to Judge Mosedale's decision in the FTT, we therefore agree with her at [23] that the SOC alleges that the appellant knew that its transactions were contrived; at [24] that if an appellant is shown to know in advance that its purchase and sale were orchestrated by a third party in order to perpetrate a fraud on HMRC, its decision to proceed would be dishonest; and at [25] that HMRC were seeking to prove that the appellant acted in a dishonest fashion, by seeking to prove that it went ahead with transactions which it knew were orchestrated for the purpose of fraud. We see no error of law in these passages.

95. The FTT was therefore in our view fully justified in the view that the allegation in fact made in this case was an allegation of dishonesty. We would accept that in general it is not necessary to use the word "dishonesty" in a pleading if it is clear what is being alleged: see the passage cited from Millett LJ in *Armitage v Nurse* at [45] above. But in the present case, Judge Mosedale records (at [37]) that HMRC's position at the hearing was that they did not allege dishonesty against the appellant. It was not suggested that she had misunderstood HMRC's position. In these circumstances we consider that she was justified in taking the view that HMRC's position was unclear, being on the one hand willing to allege that the appellant knew that its transactions formed part of a contrived scheme designed to defraud HMRC, but on the other unwilling to accept that they were alleging dishonesty.

96. In these circumstances we see nothing wrong in her direction that HMRC should clarify their stance by either expressly alleging dishonesty, or expressly disclaiming it. In our view the order she made at [40] was therefore justified, and we dismiss the appeal against this order.

97. So far as the specific grounds of appeal are concerned (set out at [34] above), Ground 1 is framed as if the FTT's conclusion was simply based on the allegation that the appellant knew that its transactions were connected with fraud. This does not seem to us to be the basis of the decision. It is true that at [42] Judge Mosedale said that she noted "in passing" that a pleading that an appellant knew that its transactions were connected to fraud had, so far as she was aware, always been considered by the FTT in MTIC cases to be a pleading of dishonesty, and at [40] and [129(1)] that if HMRC did not amend to allege dishonesty, HMRC could not advance a case that the appellant knew its transactions were connected to fraud. But as we read her decision the basis on which she made the order was that in this case the allegation was that the appellant knew that its transactions were part of a contrived scheme. As we have said it was in fact common ground before us that an allegation of knowledge within the first limb of *Kittel* does not necessarily constitute an allegation of dishonesty; and nothing we have said is to be taken as if we have decided that it does. What we have decided is that Judge Mosedale was right to conclude that the actual allegation made in this case did connote dishonesty, and that she was entitled in the circumstances to

require HMRC to make it clear what their case was.

98. Ground 2 refers to an alternative basis for her decision, namely that she took the view that to allege that a taxpayer's transaction was connected with fraud in the *Kittel* sense was to allege that it 'facilitated the fraud.' We can understand why she took this view having regard to what the Court of Justice said at [57] of *Kittel*. However she did not have the benefit of the guidance of the Court of Appeal in *Fonecomp*, which was only decided on 3 February 2015 after her decision. There Arden LJ rejected a submission on behalf of Fonecomp (at [40]) that its purchases "had to assist the fraud in some way", saying:

> "44 Furthermore in my judgment, there is nothing in Kittel which would lead to the conclusion that HMRC has to show that the transaction provides tangible assistance in carrying out the fraud. If it did, it would be difficult to prove a connection with a fraudulent transaction upstream of the transaction for which the trader seeks a repayment."

Since we have concluded that the FTT's decision was justified in any event, we do not think it matters whether Judge Mosedale was right to say (at [34]) that the assumption behind the *Kittel* principle is that the participation of the taxable person actually facilitated the fraud. We can see that in the light of *Fonecomp*, this may well have gone too far; it is not obvious that there is any meaningful distinction between the 'tangible assistance' which Arden LJ held HMRC did not need to show, and actual facilitation. But since it is unnecessary to resolve this point to dispose of the appeal, we say no more about it.

Application of the principles – E Buyer

99. Two aspects of the FTT's decision are criticised by Mr Wardell on behalf of E Buyer, the failure to require HMRC's case to be clarified, and the failure to make an order for disclosure.

100. So far as the first is concerned, HMRC in its amended SOC alleges at [38] that E Buyer's transactions formed part of an overall scheme to defraud the Revenue, that the scheme involved an orchestrated and contrived series of transactions, and that there were features of those transactions which demonstrate that E Buyer knew or ought to have known that this was the case. This is identical wording to that in the Citibank SOC at [49]. As in the Citibank case, this paragraph uses a rolled up plea of "knew or ought to have known" where we consider that it would have been preferable for HMRC to make it clear that it was intending to allege two alternative cases of (i) actual knowledge, and (ii) in the alternative, that the taxpayer should have known, but we proceed on the basis that HMRC do make both allegations in the alternative. This is confirmed by the witness statement of Officer Pabari which has since been served; see [39] above.

101. On this basis HMRC here allege that E Buyer actually knew both that there was an overall scheme, involving an orchestrated and contrived series of transactions, to defraud the Revenue, and that its transactions were part of this scheme. For reasons given above in relation to the Citibank appeal we consider that this does amount to an

allegation of dishonest conduct against E Buyer.

102. Given this, we take the view that the general principles applicable to the pleading of a case of fraud or dishonesty (which, as we say, were not disputed before us) do apply, with the result that E Buyer is entitled to have the allegation that it knew that its transactions were part of an orchestrated and contrived scheme to defraud the Revenue not only clearly alleged against it but properly particularised: see [45]-[48] above. Judge Walters refused the application for particulars because he took the view that there was no allegation made by HMRC of involvement as a co-conspirator in any fraud, but merely an allegation of knowledge of the connection with fraud, the references to an overall scheme to defraud the Revenue involving an orchestrated and contrived series of actions being a reference to the relevant circumstances surrounding E Buyer's transactions, which HMRC might relevantly allege to establish the context (at [35] of the FTT's Decision). This appears to be an acceptance of the submission made by Mr Puzey for HMRC, recorded at [27] of the Decision as follows:

> "Mr Puzey acknowledged that there was only a fine line between a case that Ebuyer knew of the connection of its trading with fraudulent evasion of VAT and a case that Ebuyer was itself a fraudulent conspirator in fraudulent evasion of VAT – but nevertheless he submitted that the line, although fine, was there, and HMRC made no allegation of fraud against Ebuyer."

For reasons we have given, we think this understates the effect of HMRC's allegation; whether or not it is an allegation of being a co-conspirator in a fraud, it is an allegation of dishonesty, and the references to the overall scheme to defraud the Revenue are not just a reference to the relevant circumstances surrounding E Buyer's transactions, but are part of what E Buyer is alleged to have known, namely that its transactions formed part of such a scheme.

103. In these circumstances we think that E Buyer was entitled to proper particulars of what it is said to have known and the facts on which such a case is based. This does not mean that it must have known the full details of the fraudulent scheme. There is clear authority, most recently in *Fonecomp*, that, as put by Arden LJ in that case at [48]:

> "Lack of knowledge of the specific mechanics of a VAT fraud affords no basis for any argument that the decision of either tribunal was wrong in law."

At [49] she cited with approval the statement of Briggs J in *Megtian* at [37]:

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

104. Nor does it mean that exhaustive and hugely detailed requests for further information are necessarily justified or proportionate. Mr Puzey referred us to a

number of statements deprecating excessive particulars: *British Airways Pension Trustees Ltd v Sir Robert McAlpine & Sons Ltd* (1994) 45 Con LR 1 at 4-5 per Saville LJ, *McPhilemy v Times Newspapers Ltd* [1999] 3 AER 775 at 792-3 per Lord Woolf MR, and *Lexi Holdings (in administration) v Pannone and partners* [2010] EWHC 1416 (Ch) at [16] per Briggs J. These are useful reminders that the purpose of particulars is to elucidate the case to enable the party opposite to prepare for trial; particulars are not a game to be played, or a rigid entitlement.

105. Although E Buyer's request was put before us, and Mr Wardell in the course of his submissions modified the request to limit it to certain paragraphs only, we received limited submissions on specific requests. In these circumstances we think the most appropriate course is to remit the matter to the FTT to decide (in the absence of agreement between the parties) in the light of our decision which requests are justified. That means balancing the general principle that in a case of dishonesty, the opposite party is entitled to have pleaded what it is he is said to have known and what are the primary facts relied on in support of that knowledge, with the principles we have just referred to. We will therefore remit the case to the FTT on that basis.

106. So far as disclosure is concerned, E Buyer sought standard disclosure akin to that required by CPR 31.6. Judge Walters declined that on the basis that litigation in the FTT was intended to conform to a different model (at [40] of the decision). Mr Wardell submitted that what was just and fair depended on the complexity of the case, and that in this case the claim concerned tax of some £7m. He instanced two particular matters. One was in relation to one of the other traders, where he submitted that HMRC were likely to have documents, but E Buyer was simply not in a position to investigate matters. The other was in relation to two officers who, according to his instructions, gave E Buyer advice as to whether E Buyer was doing everything they should. HMRC's evidence does not, he told us, refer to them at all.

107. Mr Puzey submitted that Judge Walters' decision on disclosure was a case management decision that on general principles the Upper Tribunal should be slow to interfere with, that rule 27 of the FTT Rules did not provide for standard disclosure but only for disclosure of documents that the party intended to rely on, and that there was likely to be little benefit in compiling a list of "unused" material.

108. We accept that rule 27 demonstrates that disclosure in the FTT does not simply mirror that in ordinary civil litigation. But we do not think it follows that this means that E Buyer's disclosure request should have been rejected. Rule 27 applies to a wide variety of cases, and as we said above (at [19]) the Rules provide a wide variety of powers to give effect to the overriding objective. This includes the power in rule 16 to order disclosure of other documents. It does not seem to us to be an answer to a request for wider disclosure that, in effect, a litigant before the tribunal is stuck with rule 27 and cannot complain about its inadequacy. If a reasoned case is made for wider disclosure being proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties, the tribunal should consider whether such disclosure is appropriate without being trammelled by the limited terms of rule 27. Notwithstanding that it was a case management decision, we do not think Judge Walters' decision did address the specific points made by E Buyer.

109. It therefore falls to us to consider this application afresh. We consider there is force in Mr Wardell's submissions on the facts of this case. The burden on proof is on HMRC. They hold all the cards, having carried out extensive investigations and gathered information, as they are able to do, from various sources. E Buyer is necessarily unable to have any insight into what material HMRC have uncovered other than that which HMRC chooses to rely on, and is not in a position to carry out a similar investigation itself. In the circumstances it does seem to us to be appropriate for HMRC to disclose not only the material that they wish to rely on, but also any other material uncovered in the course of their investigations which might undermine that case. So far as proportionality is concerned, there is little doubt that this case, alleging dishonesty against E Buyer and involving some £7m of tax, is both of very great importance to the taxpayer and highly complex. The case is also no doubt important to HMRC: we do not underestimate the significance of the *Kittel* principle to HMRC's continuous attempts to combat the ingenuity of those who wish to abuse the VAT system for fraudulent ends. But it does seem to us that fairness to E Buyer requires that it be given the disclosure that it seeks.

Conclusions

110. The Citibank Appeal is dismissed.

111. We are satisfied that the E Buyer Decision involved the making of an error on a point of law and in the circumstances we set aside that decision.

112. We remake that part of the decision which relates to E Buyer's application for disclosure by directing that both parties provide disclosure in the terms set out in E Buyer's application of 2 June 2014.

113. We remit E Buyer's application for further and better particulars of HMRC's case to the FTT for consideration, in the light of our decision, as to which of the revised requests for further and better particulars are justified.

MR JUSTICE NUGEE

JUDGE TIMOTHY HERRINGTON

UPPER TRIBUNAL JUDGES

RELEASE DATE: 10 March 2016