[2016] UKUT 0436 (TCC)

Appeal number: UT/2015/0017

VALUE ADDED TAX - MTIC – transactions connected with fraud – whether appellant knew or ought to have known that transactions were connected with fraud –whether HMRC's allegations involved an allegation of dishonesty – whether HMRC's pleadings were adequate – whether FTT dealt appropriately with the allegation – whether evidence of good character of director of appellant admissible - appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

PRIZEFLEX LIMITED

Appellant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: The Hon Mr Justice Morgan
Judge Greg Sinfield

Sitting in public at Royal Courts of Justice, Rolls Building, Fetter Lane, London, EC4A 1NL on 14 and 15 June 2016

David Scorey QC and Stuart Cribb, counsel, instructed by Neumans LLP, for the Appellant

Jonathan Kinnear QC and Howard Watkinson, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by Prizeflex Limited ('Prizeflex'). Prizeflex traded in mobile phones. In May and June 2006, Prizeflex entered into 16 deals whereby it purchased mobile phones from suppliers in the UK and immediately sold them to customers registered for VAT in other EU countries for delivery there. As the sales were zero-rated supplies, Prizeflex did not charge any output VAT. In its VAT returns for the monthly accounting periods of 05/06 and 06/06, Prizeflex claimed input tax of £1,326,470.87 on the purchases of the mobile phones. Each deal traced back to a defaulting trader who had charged VAT but then disappeared without accounting for it.

2. In a letter sent on 5 August 2008 (the date was wrongly typed as 5 August 2007), the Respondents ('HMRC') ruled that Prizeflex was not entitled to deduct input tax incurred on the purchase of the mobile phones on the grounds that the transactions were part of a missing trader intra-Community ('MTIC') fraud and that Prizeflex, through its director Mr Nishel Surana, knew or ought to have known that the transactions were connected with the fraudulent evasion of VAT.

3. Prizeflex appealed to the First-tier Tribunal (Tax Chamber) ('FTT'). The appeal was heard over six days in July and August 2014. Prizeflex accepted that each of the 16 transactions had been traced back to a fraudulent trader. The only issue for the FTT was whether Prizeflex, through Mr Surana, knew or should have known that the purchases of mobile phones which it carried out as part of these 16 deals were connected with fraud.

4. In a decision released on 15 October 2014, [2014] UKFTT 963 (TC), ('the Decision'), the FTT (Judge Rachel Short and Mr Richard Thomas) found that Prizeflex should have known that deal 1 was connected with fraud and had actual knowledge that all of deals 2 to 16 were connected with fraudulent transactions. Accordingly, the FTT held that all of the disputed input tax claimed by Prizeflex should be disallowed and dismissed the appeal.

5. Save as otherwise indicated, paragraph references in square brackets in this decision are to the paragraphs in the Decision.

6. Prizeflex now appeals, with the permission of the Upper Tribunal, against the Decision on seven grounds. Prizeflex had sought to appeal on eight grounds but was refused permission on one ground (Ground 7). We keep the original numbering of the grounds as that was used in argument before us.

7. For the reasons set out below, we have decided that the Decision does not reveal any error of law by the FTT. Accordingly, Prizeflex's appeal is dismissed.

Law

8. The Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of Member States relating to turnover taxes - common system of value added tax: uniform basis of assessment, ('the Sixth VAT Directive'), was the Directive in force at the time of the transactions that are the subject of this appeal. Article 17 of the Sixth VAT Directive provided that a taxable person has a right to deduct VAT which the taxable person has paid or is liable to pay in respect of goods and services supplied

to the taxable person to the extent that the goods and services are used for the purposes of the taxable person's taxable transactions (i.e. supplies of goods and services other than exempt supplies) or transactions treated as such carried out in the course of an economic activity.

9. The Court of Justice of the European Communities ('the CJEU') has determined that there is an exception to the right to deduct. In Joined Cases C-439/04 and C-440/04 *Kittel v Belgian State and Belgian State v Recolta Recycling SPRL* [2006] ECR I-6161, [2008] STC 1537 ('*Kittel'*), the ECJ held that a taxable person who knew or should have known that, in purchasing goods, he was taking part in a transaction connected with the fraudulent evasion of VAT, loses the right to deduct input tax on those goods.

10. In *Kittel*, the CJEU stated at [51]:

> "… traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT …"

11. At [56] – [59] of *Kittel*, the CJEU concluded as follows:

> "56. … a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
>
> 57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
>
> 58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.
>
> 59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'."

12. In *Mobilx Limited and others v HMRC* [2010] EWCA Civ 517, [2010] STC 1436 ('*Mobilx'*) the Court of Appeal considered the meaning of "should have known" in *Kittel*. Moses LJ, with whom Carnwath LJ and Sir John Chadwick agreed, held at [59] and [60]:

> "59. The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel.*
>
> 60. The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with

> fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

13. Moses LJ further stated at [64]:

> "If it is established that a trader should have known that by his purchase there was no reasonable explanation for the circumstances in which the transaction was undertaken other than that it was connected with fraud then such a trader was directly and knowingly involved in fraudulent evasion of VAT. The principle in *Kittel*, properly understood, is, as one would expect, compliant with the rights of traders to freedom from interference with their property enshrined in Art. I of the First Protocol of the European Convention of Human Rights. The principle in *Kittel* does no more than to remove from the scope of the right to deduct, a person who, by reason of his degree of knowledge, is properly regarded as one who has aided fraudulent evasion of VAT."

Background

14. The FTT set out the agreed facts about the transactions at [2] and [3], the background to Prizeflex and the 16 deals at [6] and [7], the evidence at [13] to [56] and their findings of fact at [89] to [98]. There is no challenge of the type described by the House of Lords in *Edwards v Bairstow* [1956] AC 14 to the primary findings of fact by the FTT. For the purposes of this appeal, the relevant facts can be summarised as follows.

15. Prizeflex was incorporated in 1987 and registered for VAT shortly thereafter describing its business as "importer/exporter/wholesale of jute goods and clothes". Mr Sumati Surana was a director of Prizeflex from 1987 until his death in 2009. Mr Nishel Surana is his son.

16. From 2003, having left university and gone to work for telecommunications company O2, Mr Nishel Surana worked in the business on a part time basis. In July 2004, Prizeflex's trade classification for VAT purposes was amended to include "telecommunication". On 26 July 2004, HMRC wrote to Prizeflex setting out the scale of MTIC fraud and asking the company to carry out 'Redhill verification' on their counterparties. HMRC visited Prizeflex on 24 August 2004 and explained joint and several liability and Redhill verification.

17. On 26 May 2005, Prizeflex applied to make monthly VAT returns. HMRC visited Prizeflex again on 24 June 2005 and issued Prizeflex with VAT Notice 726 'Joint and several liability for unpaid VAT'. On 1 December 2005, HMRC wrote to Prizeflex setting out their requirements for the documents which should be retained by traders and requesting the company's export records.

18. In April 2006, Mr Nishel Surana was made a director of Prizeflex and started working full-time for the company. He had experience in the mobile phone market including in UK to UK sales. Mr Surana had sole responsibility for Prizeflex's mobile phone business and was the controlling mind of Prizeflex in relation to that business. Mr Surana had seen and understood Notice 726 and was aware of the risk of fraud in the mobile phone market. He had seen HMRC's letters of 26 July 2004 and 1 December 2005. He was also aware of HMRC's statements to Prizeflex in their meetings on 24 August 2004 and 24 June 2005.

19. Between 9 May and 3 July 2006, Prizeflex entered into 16 deals involving the purchase and sale of mobile phones on a back to back basis. Nine different types of mobile phone handsets were supplied in each of these deals; of these, only the Nokia N80, Nokia N9300i and the Nokia N91 were new to the market in the second quarter of 2006, the other handsets were old models, in some cases more than two years old. The trades involved 11 different suppliers and customers. All the purchases and sales were perfectly matched with no surplus of supply or shortfall in demand. Some due diligence was done by Prizeflex for both its buyers and sellers, including Redhill VAT checks and credit checks. Invoices from other participants in this market were not always precise as to the details of the phones being purchased. The goods were sold by Prizeflex on "ship on hold" terms but the precise date on which the goods were released to their buyer in the EU and how and when title to the goods passed was not completely clear either from the documents or Mr Surana's evidence. Prizeflex paid for insurance of the phones which they were responsible for transporting, whether or not they had title to those phones at the time of shipping. Although initially not admitted, by the time of the FTT hearing there was no dispute that each of the 16 deals which were the subject of the appeal had been traced to a fraudulent trader.

20. The pattern of trading for Prizeflex's UK deals was markedly different from that in the 16 EU transactions. The EU deals gave a profit of £399,019 with a profit margin of between 2.9% and 7.9% and an average profit margin of 5.9%. By comparison the UK to UK deals entered into by Prizeflex usually gave rise to a profit of £1 per phone.

21. Prizeflex had a turnover of £209,309 in the quarterly VAT period 09/04 which was the first one after the company had amended its VAT trade classification to include "telecommunication". Prizeflex's turnover for the monthly VAT period 05/06 was £5,279,682. Prizeflex's total turnover in 2006 was £25 million. In period 05/06, 92% of all sales by Prizeflex were to the EU: the percentage in period 06/06 was 97%.

22. On 12 September 2006, two HMRC Officers carried out a further visit to Prizeflex and obtained detailed information about its mobile phone business. In a letter of 24 September, Prizeflex notified HMRC of the details of the due diligence which the company undertook on their suppliers and customers.

23. HMRC denied Prizeflex the right to deduct input tax claimed in respect of the 16 EU transactions in the letter of 5 August 2008, to Mr Surana at Prizeflex. The letter stated:

> "I am satisfied that the transactions … form part of an overall scheme to defraud the revenue. I am also satisfied that there are features of those transactions, and conduct on your part, which demonstrates that you knew or should have known that this was the case, in that you either deliberately, or recklessly, ignored factors which indicated that these transactions may have formed part of such an overall scheme."

24. Prizeflex appealed against HMRC's decision in a Notice of Appeal dated 3 September 2008. HMRC set out their case in an Amended Statement of Case dated 23 October 2013. In relation to the connection to fraud, the Amended Statement of Case stated that HMRC had traced the chain of transactions to defaulting traders and continued as follows:

> "[HMRC] assert that those defaulting traders occasioned fraudulent tax losses. Further, [HMRC] assert that the fraudulent defaulting traders did not

> operate in isolation, but operated as part of an orchestrated overall scheme to defraud the Revenue of which [Prizeflex's] transactions formed a part.
>
> All 16 of [Prizeflex's] relevant transactions were part of an overall MTIC fraud scheme involving a web of companies where the sole aim was to defraud the Revenue of VAT due to it. The transactions were orchestrated and contrived for such a purpose and had no ordinary commerciality to them."

25. The Amended Statement of Case then set out 13 items of evidence which HMRC contended established the existence of an overall scheme to defraud the Revenue, of which Prizeflex's transactions were a part. The thirteenth item of evidence was said to show that "this was no 'one-man' fraud carried out alone by each defaulting trader but that the transaction chains formed part of an overall scheme to defraud the Revenue."

26. The Amended Statement of Case also included an alternative to the connection with fraud shown by Prizeflex's transactions forming part of an overall scheme to defraud the Revenue, namely reliance upon the connection with fraud as established by the transaction chains between Prizeflex's transactions and the fraudulent defaulting traders. Paragraph 31 of the Amended Statement of Case stated:

> "In the alternative to the connection with fraud shown by the Appellant's transactions forming part of an overall scheme to defraud the Revenue, the Respondents rely upon connection with fraud as established by the transaction chains between the Appellant's transactions and the fraudulent defaulting traders."

27. Paragraph 48.1 of the Amended Statement of Case stated:

> "[HMRC] contends that the existence of an overall scheme to defraud the Revenue in which [Prizeflex] played the pivotal role of broker provides a compelling inference that [Prizeflex] knew that the transactions were connected with the fraudulent evasion of VAT. That all of [Prizeflex's] broker transactions in VAT periods 05/06 and 06/06 traced to a fraudulent defaulting trader is beyond coincidence."

28. In support of their assertion that Prizeflex played a pivotal role, HMRC set out various matters relied upon in the Amended Statement on Case including the following:

> "48.4 [Prizeflex] always received payment from its customer before it paid its supplier. That [Prizeflex] was able to enter into such fortuitous payment arrangements was too good to be true and clearly so.
>
> 48.9 [Prizeflex] always made a vastly greater profit than any other UK participant in the transaction chains. [HMRC] assert that the fraudsters orchestrating the transaction chains would never have permitted an unwitting party to make off with such a large part of the monies generated by the fraud. There was no commercial rationale for [Prizeflex] to make such vastly greater profits than others in the UK chain, conversely there was every reason for a broker in an MTIC fraud that knew that its transactions were connected with the fraudulent evasion of VAT to receive such large profits: it bore the biggest risk of being out of funds if its reclaim was denied.
>
> …
>
> 48.14 That [Prizeflex] approached its UK - UK transactions differently from its broker transactions indicates that it knew that the latter were connected with the fraudulent evasion of VAT.
>
> …

> 48.17 [Prizeflex's] approach to inspection of the goods that it sold indicates that it had no commercial level of interest in the goods because it knew that they were simply a vehicle for the facilitation of transactions connected with the fraudulent evasion of VAT."

29. By the time of the hearing before the FTT, Prizeflex had accepted that there had been a loss of VAT due to fraud by a defaulting trader to which Prizeflex's transactions were connected. As is clear from [3], the issues before the FTT were whether Prizeflex knew, or in the alternative should have known, that its transactions were connected with the fraudulent evasion of VAT.

30. HMRC set out their case for the hearing in lengthy written submissions which comprised 60 pages of submissions supported by 83 pages of appendices. Their primary contention was set out in paragraphs 1.9 and 1.10:

> "The Respondent's overarching submission is that all 16 of the Appellant's 'broker' transactions in the 05/06 and 06/06 VAT periods were part of an overall MTIC fraud scheme involving a web of companies and chains of 'transactions,' the sole aim of which was to defraud the Revenue of VAT due to it. The transactions were orchestrated and contrived for such a purpose and had no ordinary commerciality to them.
>
> The Respondents' primary contention is that the Appellant knew that its transactions were connected with a VAT fraud and must have known of that connection to have both played such an integral role in the fraud and taken such a significant share of the profits."

31. HMRC alleged that the transactions were carried out as part of an orchestrated scheme to defraud the Revenue. At paragraph 6.3 of the opening submissions, HMRC stated that "as a matter of logic a Tribunal can conclude that the more heavily orchestrated and efficient a fraudulent scheme is the more likely it is that each party knew its role therein." HMRC later submitted, at paragraph 6.7, that the fact that the transactions were orchestrated by fraudsters as part of an overall scheme allowed only two possibilities in relation to Prizeflex's state of knowledge, namely that Prizeflex was involved as a knowing party to the scheme or that it should have known that its transactions were connected to fraud. At 6.17, HMRC stated that:

> "[T]he well oiled fraudulent scheme that Prizeflex formed an integral part of did not rely upon chance or upon duping innocent traders into buying from and selling to the right people, it relied upon each party knowing, and performing, its role."

32. Having summarised the details of the transactions alleged to be connected to fraud, and the evidence relied upon, HMRC submitted, at 6.65, that:

> "… The transactions that are the subject of this appeal could only be successfully orchestrated by either ensuring that each participant knew from whom to purchase and to whom to sell in each chain or by successfully duping the participants into such a position without their actual knowledge. It is impossible that the Appellant could have been duped so many times, by so many different suppliers and customers."

33. In the conclusions as to knowledge in the opening submissions, HMRC stated that "the Tribunal can be quite satisfied that the Appellant was no innocent in the transaction chains." HMRC's opening submissions also explained their case, in the alternative, that Prizeflex should have known of the connection between its transactions and fraud.

34. The case put on behalf of Prizeflex was stated in paragraph 7 of its skeleton argument to be that:

> "The Appellant has been unwittingly used by sophisticated fraudsters to fund a fraudulent scheme which enabled others to steal VAT. Indeed, the Tribunal may conclude that as a result of the Respondent's decision, Prizeflex has become the victim of this fraud."

35. How Prizeflex understood the case being put against it can be seen from paragraphs 17 and 18 of the skeleton argument for the hearing before the FTT:

> "17. The Respondent's primary case is that Prizeflex, through its directors was at the heart of a sophisticated VAT fraud in which every member of a long supply chain was involved. Surprisingly, however, HMRC have advanced little evidence about the companies that directly traded with Prizeflex.
>
> 18. These allegations are extremely serious and plainly implied dishonesty against Mr Sumati Surana, now deceased, and Mr Nishel Surana. …"

36. Paragraph 55 stated:

> "The Respondent is alleging that Mr Nishel Surana is a dishonest man who has deliberately engaged in fraud. A key task for the Tribunal will be to assess the character of Mr Surana and his understanding of his business."

37. As the FTT recorded at [4], counsel for Prizeflex raised a number of preliminary objections to the way in which HMRC put their case on the first day of the hearing. In particular, Prizeflex sought to exclude evidence of certain matters that had not been particularised in HMRC's Amended Statement of Case. The FTT set out the objections to the evidence and the FTT's rulings on them in three subparagraphs to [4] as follows:

> "(1) Mr Fletcher's status as an expert witness and the potentially biased nature of his evidence.
>
> In previous directions of 20 October 2011 Judge Berner considered whether Mr Fletcher's evidence could be allowed as expert evidence in this case and confirmed that it could be. The Tribunal therefore refused Mr Farrell's request to exclude this evidence but took notice of his comments concerning the weight which should be given to it.
>
> (2) The late inclusion of allegations concerning an alleged loan of £150,000 made on 1 June 2006 to Prizeflex by Mr Mohammed Shabir Patel, a director of First Solutions (England) Ltd and Mobile Solutions, supplier to one of Prizeflex's suppliers. The lateness was exacerbated by the fact that the main witness for Prizeflex involved in the making of this loan, Mr Sumati Surana, was now dead.
>
> The Tribunal agreed with Mr Farrell that HMRC's references to the significance of the alleged loan from Mr Patel in their statement of case had not been clearly set out, but nevertheless did not consider that there was sufficient prejudice to Prizeflex in having to deal with this issue to persuade the Tribunal to exclude the evidence.
>
> (3) A lack of detailed pleadings of fraud, which had to be specifically pleaded. Mr Farrell referred to a number of allegations of fraud which he said had not been specifically pleaded by HMRC including the allegation that Prizeflex had dealt with fraudulent traders in Germany in 2009.
>
> The Tribunal accepted the principle that allegations of fraud had to be specifically pleaded but considered that since it had been accepted by the parties that the deals in dispute had been traced to fraudulent transactions, HMRC's case was based on Prizeflex's knowledge of the fraud of others,

> rather than its own fraudulent dealings, therefore Mr Farrell's point of principle was not strictly relevant."

38. In connection with the matters referred to in the last paragraph, we have also considered the transcript of the hearing on 28 July 2014. We have had regard to the submissions made to the FTT on those matters and to the terms of the ruling given by the FTT following their consideration of those submissions. The FTT stated that their decision in relation to the allegation about the loan and the points as to HMRC's pleading was based on their assessment of whether those matters could be fairly investigated and determined. They held that it was not unfair to Prizeflex to investigate those matters at the hearing before them.

39. Mr Nishel Surana gave evidence at the hearing and was cross examined by Mr Kinnear QC, leading counsel for HMRC. During cross examination, Mr Kinnear put a number of allegations of dishonest knowledge to Mr Surana such as the following from day three of the hearing:

> "Q. But you've had all these letters from Customs it's been described to you what's happening, you have made up your own due diligence, you've asked for no Customs stamps, did you never for one moment stop and say 'oh my goodness, this might be carousel fraud'?
>
> A. No, I did not.
>
> Q. That's because you knew, Mr Surana. There was nothing about stopping and thinking, you knew exactly what was going on, didn't you?
>
> A. No, I did not know."

40. On the final day of the hearing, Mr Kinnear submitted that HMRC did not need to prove dishonesty:

> "The allegation, the pleading in this case, is one which is based on the *Kittel* test. And the test for the Tribunal is not whether or not he was involved in a criminal conspiracy, whether he was dishonest or otherwise; the test is whether he either knew or should have known that his transactions were connected with fraud.
>
> As a subsidiary matter, we have pleaded that the transactions took place within a scheme which was orchestrated and/or contrived. And it is right they must have known, in our submission, about the transactions. But it's not part of our case; we don't have to prove dishonesty or criminal conspiracy or anything of the sort."

41. Mr Kinnear also made the following submission about the loan:

> "We submit, given the circumstances of the loan and who it came from and how it came to the appellant, and when it came into the appellant's account, that you can be quite sure that Mr Surana was not telling the Tribunal the truth whenever he dealt with the issue of the loan. Why was he not telling the truth? Because to admit that you were getting a loan or money from one's supplier's supplier in our submission undermines everything that he has said in both his written and oral evidence in relation to not being able to know who was further up the chain than his supplier. It effectively undermines his whole case, and we submit for that reason that that issue of the loan is really quite important."

42. Mr. Farrell QC, then counsel for Prizeflex, said in his final submissions to the FTT:

> "It's true, of course, that dishonesty is not part of the *Kittel* test, that is undoubtedly the case. However, if it's the case that its proved against me that I know my transaction is connected to a fraudulent tax loss, in my submission, it must follow, from my knowledge that I'm engaging in a fraud, that I had in fact been dishonest. It's therefore of course technically not part of the test, but it is a very high hurdle for my learned friend to get over."

43. After the end of the hearing before the FTT, both parties made closing submissions in writing. HMRC repeated their case and stated, at 1.11, that "Mr Surana did not tell the truth during the course of his evidence, with the purpose of concealing his true state of knowledge" and later that "[t]he only reason that Mr Surana had for giving evidence in the manner in which he did was because he knew that the transactions were connected with the fraudulent evasion of VAT."

44. In its written closing submissions, Prizeflex set out the case against it as follows:

> "26. The Respondent first asserts that simply by looking at the nature of the fraud uncovered one can conclude that the Appellant must have been a knowing conspirator.
>
> 27. This allegation is one that straightforwardly alleges that Nishel Surana was involved in a criminal conspiracy."

45. Prizeflex further submitted, at 41 and 42, that:

> "41. … the far simpler and more probable conclusion is that the Appellant company was not connected to the other companies and was quite separate from those at the heart of the fraud who all banked with the FCIB and was preyed upon by those fraudsters.
>
> 42. Taking all of these matters together it is submitted that the nature of the fraud does not demonstrate knowing participation in the fraud."

The Decision

46. In the Decision, the FTT set out the passages from *Kittel* and *Mobilx* quoted in [11] and [12] above. The FTT also referred to some of the subsequent decisions of the FTT and this tribunal which considered *Kittel* and *Mobilx* including *Else Refining and Recycling Limited v HMRC* [2012] UKFTT 407(TC), *JDI Trading Limited v HMRC (*LON/2008/1179) and *Davis and Dann Ltd and another v HMRC* ([2013] UKUT 0374) from which they concluded, in [12], that:

> "HMRC need to produce clear and compelling evidence to demonstrate actual knowledge of fraud, given that the hurdle for constructive knowledge is itself a high one."

47. The FTT set out the evidence at [13] to [56] and the parties' submissions at [57] to [87]. In [70], the FTT recorded that HMRC had submitted that "Prizeflex's transactions took place as part of a highly orchestrated and well-oiled fraud which itself indicated that all participants, including the Appellant, knew the transactions were fraudulent." In [73], the FTT noted that Mr Kinnear:

> "… set much store by the argument that the deals were so highly orchestrated and contrived that Prizeflex must have known that they were fraudulent because the directing minds of the deals would not have risked an innocent dupe in the circle of deals. An innocent dupe might sell to the wrong person or buy from the wrong person, in which event the funds would leave the control of the fraudsters, or the innocent dupe might report their suspicions to HMRC."

48. Having made their findings of fact in [89] to [98], which are incorporated in our description of the facts at [15] to [23] above, the FTT stated their conclusion at [100] before giving their reasons for it. The FTT found that Prizeflex knew that the second to sixteenth deals were connected to fraud and should have known that the first transaction was connected to fraud.

49. The FTT then made some points on the evidence in [102] to [107]. In [102], the FTT stated that they had not treated the evidence of Mr Reardon, HMRC officer, which went to "the circularity and contrived nature of the deals as critical to their decision on the basis that it had been conceded by Prizeflex". It was common ground before us that Prizeflex had only accepted that the evidence showed circularity in eight of the sixteen transaction chains and, indeed, the FTT recorded the concession accurately in [60]. We do not read [102] as an erroneous finding by the FTT that it had been conceded that all sixteen deals were circular. The FTT refer to the "circularity and contrived nature" of the deals. The FTT was entitled to say that all of the deals were contrived even if some of them were not circular. Initially, we had a little difficulty in understanding what the FTT meant by saying that the contrived nature of the deals was not "critical". Reading the Decision as a whole, it seems to us that the FTT regarded the nature of the transactions as important in their overall assessment of what Mr Surana knew or should have known. We consider that the right way to read [102] is to hold that the FTT was saying that because the contrived nature of the deals was conceded, it was not critical for them to set out in their Decision all of the facts as to the contrived nature of the deals.

50. The FTT stated, in [103], that they had not relied to any great extent on Mr Fletcher's evidence about how the grey market in mobile phones operated except to conclude that Nokia had a single pricing policy and that the existence of a grey market depended on arbitrage of price or supply between markets.

51. The FTT repeated, in [105], the test, derived from *Kittel* and *Mobilx*, that they had to apply. It is clear that the FTT understood that the central question which they had to answer was whether Prizeflex knew or should have known that its transactions were connected with the fraudulent evasion of VAT.

52. The FTT then stated in [106]:

> "Contrary to the Appellant's contentions, it is not necessary for the Tribunal to conclude that Prizeflex, through its director Mr Surana, is either a fraudulent company itself or involved in a fraudulent conspiracy. The Appellant spent some time discussing Mr Surana's character, but we do not consider that this is relevant to this appeal."

53. We interpret the first sentence of [106] as a correct statement of the law in that the central question which the FTT had to answer, in accordance with the correct self-direction in [105], was whether Prizeflex knew or should have known that its transactions were connected with the fraudulent evasion of VAT.

54. It is not clear to us precisely what the FTT meant by the second sentence of [106]. Before the FTT, it appears to have been accepted that Prizeflex was entitled to lead evidence of good character in relation to Mr Surana. HMRC did not submit that such evidence would be inadmissible. Against that background, it seems unlikely that the FTT was giving a legal ruling that good character evidence was inadmissible. It seems

to us to be much more likely that the FTT was saying that the general evidence they had been given as to Mr Surana's character was not material when they considered the specific questions as to whether Mr Surana knew or ought to have known that the transactions were connected to fraud. We will return to this question later in our decision.

55. Having made the points on the evidence, the FTT set out their reasons for their conclusions at [108] to [123]. The FTT had earlier made the point, at [101], that the order in which they gave their reasons reflected the comparative weight given to different parts of the evidence and that they would indicate where they relied on factors in combination rather than separately.

56. The FTT stated, in [108], that they considered that the fact that, despite being an intelligent and sophisticated businessman, Mr Nishel Surana was unable to provide a convincing commercial explanation, or any written evidence, of why deals 2 to 16 were entered into, how they were negotiated, how particular buyers were found for particular sellers or vice-versa or why it was that no deals failed, were only partially fulfilled or were fulfilled by more than one supplier was the most compelling evidence that Prizeflex knew that the transactions were fraudulent when it entered into them. The FTT stated that this was "[t]he most compelling evidence".

57. The FTT commented in [109] that while Mr Surana's evidence was generally cogent and clear, it was far from that when he was asked to explain the commercial negotiations surrounding the deals. That led the FTT to conclude that the deals were not commercially negotiated because they were connected with fraud and that Mr Surana was aware that there was no commercial negotiation and that the reason there was no commercial negotiation was because of the connection with fraud.

58. The FTT stated that they also relied heavily on the fact that Mr Surana understood the UK mobile phone market, having carried out a number of UK deals prior to and at the same time as the disputed transactions, and those UK deals were carried out in a very different way. For example, in the UK deals, Prizeflex recorded the IMEI numbers (unique identifying numbers) of the phones traded whereas it did not do so for the EU deals. The FTT concluded, in [110], that the only reason for the difference in treatment was because Mr Surana knew that the EU deals were connected with fraud.

59. In [111], the FTT found that Mr Surana was well aware of the risk of fraud in the mobile phone market in which he operated and found it difficult to understand how an intelligent man such as Mr Surana, who had understood the risk of being involved in fraud sufficiently well to implement the measures which he did, would nevertheless enter into transactions which had the hallmarks of fraudulent deals without raising any concerns. The FTT concluded that Mr Surana was willing to do so because he knew that the deals were connected with fraud and was happy to participate in them.

60. The FTT, at [112], rejected Mr Surana's alternative explanations as to why the deals were done on the relevant terms, namely explosive growth in the grey market, as unconvincing. The FTT noted that the age of the models traded and their release dates suggested that, in the main, there would not have been a large demand for them so as to justify the margins being made by Prizeflex.

61. The FTT also noted that, despite the varying type and age of the handsets traded, the patterns of dealing did not differ. The FTT found, in [113], that, given his knowledge of the market, Mr Surana must have been aware that such consistency in trades involving different models of phone could only be explained by the transactions being driven by fraud.

62. The FTT identified, in [114], a number of actions taken by Prizeflex which, while not necessarily showing an intention knowingly to enter into fraudulent deals if viewed in isolation, in combination with the actions set out above, suggested that Mr Surana knew that he was entering or about to enter into fraudulent deals. Those actions were:

> (1) The fact that Prizeflex asked to be put on monthly VAT accounting from 9 May 2005;
>
> (2) The fact that Mr Surana stopped recording IMEI numbers before any of these deals were entered into;
>
> (3) The fact that 'Redhill checks' were done on three of Prizeflex's main suppliers for deals 1 – 16 at the same time on 25 April 2006.

63. At [115], the FTT found that the level of profit made by Prizeflex in the transactions, when set against the amount of work required in return and the risk involved, suggested that Mr Surana knew that he was being rewarded for taking part in fraudulent transaction chains. The FTT concluded that Prizeflex's willingness to wait for a VAT repayment and thus provide cash flow to its suppliers because, as Mr Surana said, others might not be willing to provide it, indicated that Mr Surana was aware of more participants in the transactions than he had suggested in his evidence.

64. In [116], the FTT set out a number of matters that coloured their view of Prizeflex's activities without regarding them as compelling in themselves. The FTT considered that the release notes produced by Prizeflex were haphazard which was not consistent with it having a real commercial stake in the goods. The FTT found that Mr Surana's attempts to explain the discrepancies were not supported by the evidence of Prizeflex's other witness, Mr Raithatha, or by commercial common sense. The FTT also found that Prizeflex's due diligence appeared to be mainly a 'box ticking' exercise, with no evidence of any attempt to take a realistic view of the possibility of fraud being present which the FTT considered was not an adequate response to the risk of fraud. The FTT said that their view was not affected by the fact that "Mr Surana never dealt directly with a fraudulent trader (i.e. the person in the deal that failed to pay the VAT)".

65. In [117], the FTT set out four submissions by HMRC which they took into account without according them much weight. First, the FTT considered that HMRC's argument that the very orchestrated nature of the fraud meant that each participant must have known that the deals were connected to fraud was not a sufficient answer to the question of what Prizeflex actually knew as a participant in the chain. The FTT accepted that there was some force in the related argument that the fraud would only work if Prizeflex was not an innocent dupe but was a knowing participant although, while persuasive, it was not conclusive. The FTT observed, however, that Mr Surana did not appear to be someone who would be easily duped in the mobile phone market. HMRC had referred to the loan which appeared to have been made to Prizeflex by one of its suppliers' suppliers as suggesting that the company was involved in the fraudulent chain beyond its immediate counterparties. However, the FTT stated that they had "not

relied on this [evidence of the loan] as a significant piece of evidence". Finally, in relation to the evidence tracing the payments in each transaction through various FCIB accounts, the FTT did not accept that the fact that Prizeflex did not have a FCIB account suggested innocence but neither did they accept HMRC's submission that circularity of funds necessarily proved that Prizeflex had knowledge of a connection to fraud.

66. In [118] to [123], the FTT stated their conclusion that Prizeflex should have known that deal 1 was connected with fraud and their reasons for reaching that conclusion. In [122], the FTT found that there were enough hallmarks of fraud to put Mr Surana on notice that the deal was fraudulent. The FTT set out the relevant hallmarks and their conclusion as follows:

> "… the importation pattern, the type of phones imported (Nokia 7610s – which were first released in mid 2004, so were actually very old by this date) and the margin which he made; 6.9% and £25,500.00 of profit. Adding those factors to what Mr Surana had been told by HMRC about the existence of fraud in this market, we have concluded that Mr Surana should have known that the only reasonable explanation for the unusual features of this transaction was that it was connected with fraud."

Grounds of appeal

67. Prizeflex applied to the FTT for permission to appeal to the Upper Tribunal on eight grounds. The FTT refused permission on all grounds and Prizeflex applied to the Upper Tribunal. The Upper Tribunal granted permission to appeal against the decision of the FTT on seven grounds. Those grounds may be summarised as follows (using the original numbering):

1. The FTT misunderstood HMRC's case against Prizeflex and failed to appreciate that dishonesty was alleged and these errors of approach impaired the fact-finding process and led to further errors identified in grounds below.

2. The FTT erred in allowing HMRC to contend that Prizeflex, through its director Mr Nishel Surana, knew that the transactions were contrived and/or connected to fraud without specifically alleging dishonesty, particularly in view of HMRC's disavowal of any allegation of dishonesty.

3. The FTT erred in rejecting Prizeflex's complaints that HMRC's pleading lacked particularity when they held at [4(3)] that:

> "The Tribunal accepted the principle that allegations of fraud had to be specifically pleaded but considered that since it had been accepted by the parties that the deals in dispute had been traced to fraudulent transactions, HMRC's case was based on Prizeflex's knowledge of the fraud of others, rather than its own fraudulent dealings, therefore Mr Farrell's point of principle was not strictly relevant."

Prizeflex contends that the FTT should have concluded that HMRC's case alleged fraud and dishonesty against others in the transaction chains, including Prizeflex, and the FTT should have required HMRC to particularise those allegations because that dishonesty was relied on by HMRC.

4. The FTT were wrong to exclude evidence and submissions relating to Mr Nishel Surana's character as irrelevant when the case against him necessarily impugned his honesty.

5. The FTT's findings of fact did not support the conclusion that Prizeflex, through Mr Nishel Surana, knew that the transactions were connected to fraud.

6. The FTT wrongly allowed HMRC to introduce, at a late stage, evidence in relation to a loan of £150,000 to Mr Surana senior in June 2006 when he was a director of Prizeflex.

8. The FTT erred in concluding that Prizeflex ought to have known that deal 1 was connected with fraud.

Overarching submission Grounds 1 – 3 - dishonesty and nature of fraud

68. It is appropriate to deal with grounds 1 to 3 together as they are the subject of an overarching submission in relation to dishonesty and the nature of the fraud in this case as well as being relied on individually. The same overarching point was also made in relation to ground 4 but that was overtaken by written submissions after the hearing and it is appropriate to consider it separately.

69. Mr Scorey QC, counsel for Prizeflex before us, made detailed and thorough submissions in support of these grounds of appeal (and, indeed, in relation to all the grounds of appeal). It is right that we deal in detail with the many separate points which he made although, as we will explain, we also think that we should stand back and consider whether any of the points raised, taken individually or in combination, cause us to have concerns about the findings of fact made by the FTT and/or the fairness of the procedure by which those findings were arrived at.

70. Mr Scorey's overarching submission was that HMRC's allegation that Prizeflex knew or ought to have known that the transactions were connected to fraud necessarily meant that Prizeflex, in the person of Mr Surana, had acted dishonestly. The FTT had misunderstood HMRC's case against Prizeflex and this meant that the FTT had failed to apply the procedural safeguards that apply to cases of dishonesty. He also contended that HMRC's primary case was that every person, including Prizeflex, in the transaction chains was a knowing participant in the fraud and HMRC's alternative case was that the transaction chains connected Prizeflex to the defaulter who committed the fraud. Mr Scorey submitted that the nature of the fraud alleged must be clear in order to determine what is relevant and what is irrelevant. However, it was not evident from the decision that the FTT understood the cases being put by HMRC or determined whether HMRC had established their primary or alternative case. Mr Scorey referred to HMRC's closing submissions in relation to actual knowledge. He submitted that it was unclear who the parties, on whose wrongdoing the fraud depended, were. He accepted that HMRC only had to show a connection to the fraud by the defaulter but submitted that, where they relied on wrongdoing by others, that wrongdoing must be properly proved. The findings of the FTT do not support the inference that Prizeflex was a knowing participant in a fraudulent scheme, which was HMRC's primary case, nor do they identify the alternative fraud of which Prizeflex should have known. Mr Scorey submitted that there were no factual findings by the FTT on the nature of the fraud.

71. Mr Scorey submitted that HMRC had failed to plead the allegations of fraud distinctly and with precision or to particularise them properly. He relied on the dicta of Millett LJ, as he then was, in *Armitage v Nurse* [1998] Ch 241 (CA) at pp. 254-7:

> "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 LJ. 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. If he uses language which is equivocal, rendering it doubtful whether he is in fact relying on the alleged dishonesty of the transaction, this will be fatal; the allegation of its dishonest nature will not have been pleaded with sufficient clarity.'
>
> That case 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)."

72. Mr Scorey also relied on what Lord Millet said in [183] to [186] of *Three Rivers District Council v Governor and Company of the Bank of England (No.3)* [2003] 2 AC 1 HL ('*Three Rivers*') in which he affirmed the principle set out in *Armitage v Nurse* that fraud or dishonesty must be distinctly alleged and sufficiently particularised and that particulars of facts which are consistent with honesty are not sufficient.

73. Mr Scorey emphasised that Prizeflex's submissions were not merely pleading points. It was common ground before us that the *Kittel* test of "knew or ought to have known" is a composite pleading or shorthand for two separate allegations. Mr Scorey accepted that the statement in *Armitage v Nurse* must give way to the way in which *Kittel* has been understood in the tax tribunals and courts i.e. as a rolled up pleading of two separate and alternative allegations. We agree, although we also endorse the statement of the Upper Tribunal in *E Buyer UK Ltd v HMRC and HMRC v Citibank NA* [2016] UKUT 123 (TCC) ('*E Buyer'*), at [91], that:

> "… it [is] 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."

74. Mr Scorey took us in detail through the decision in *E Buyer*. That case concerned two separate appeals, by E Buyer and Citibank. In each appeal, HMRC made the same allegation, namely 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 demonstrated that the appellant knew or ought to have known that this was the case. The issue, as relevant to this appeal, was whether HMRC had properly pleaded and particularised the allegation which E Buyer and Citibank contended was an allegation of dishonesty or wrongdoing. HMRC contended that the pleadings simply alleged, in accordance with *Kittel*, that the appellants knew or should have known that the transactions were

connected to fraud and that was not an allegation of dishonesty and so HMRC were not required to plead it or particularise it. The Upper Tribunal, while accepting that *Kittel* had not laid down a test of dishonesty, did not accept HMRC's submission that they were not alleging dishonesty in relation to E Buyer and Citibank.

75. Having reviewed the relevant authorities, the Upper Tribunal in *E Buyer* set out their conclusions at [86] 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."

76. We respectfully agree with the principles set out by of the Upper Tribunal in *E Buyer* in [86] and their comment at [88] that the relevant question is whether in any particular case the allegations in fact made by HMRC do or do not amount to an allegation of dishonesty. There is, however, an important point of distinction between *E Buyer* and this case. Both E Buyer and Citibank concerned applications to the FTT for directions that HMRC provide further and better particulars of their statements of case in advance of any hearing of the substantive appeals. That is not the situation in this case where the hearing of the appeal before the FTT proceeded on the basis of the case as pleaded in HMRC's Amended Statement of Case. That was also the position in *Megtian Ltd v HMRC* [2010] EWHC 18 (Ch) ('*Megtian*') which the Upper Tribunal in *E Buyer* considered at [67] to [74].

77. In *Megtian*, HMRC had disallowed Megtian's input tax claim on the grounds that Megtian knew or ought to have known that the relevant transactions were connected with fraud. Megtian appealed and the VAT and Duties Tribunal dismissed the appeal. Megtian appealed to the High Court. One of Megtian's arguments on appeal 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. Briggs J (as he then was) rejected that contention, in [49] to [50] of the judgment, on the ground that:

> "49. … 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 [Megtian's sole director] 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. [Counsel for Megtian] 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 …"

78. The Upper Tribunal in *E Buyer* commented on this passage from *Megtian* at [72] and [74] as follows:

> "72. It can be seen that what [Briggs J] 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.
>
> …
>
> 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, preordained 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."

79. In *E Buyer*, the Upper Tribunal held that HMRC were alleging dishonest conduct on the part of E Buyer and it was 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. As the Upper Tribunal observed at [103], however, that did not mean that E Buyer must have known the full details of the fraudulent scheme citing comments by Arden LJ in *Fonecomp* at [48] and [49] approving a statement of Briggs J in *Megtian* at [37]. Further, the Upper Tribunal stated, in [104], that the purpose of particulars in pleadings is to elucidate the case to enable the other party to prepare for trial and that "particulars are not a game to be played, or a rigid entitlement."

80. In support of that view, with which we agree, the Upper Tribunal in *E Buyer* referred to a number of cases, including *McPhilemy v Times Newspapers Ltd* [1999] 3 AER 775 in which Lord Woolf MR stated at 792-3:

> "In the majority of proceedings identification of the documents upon which a party relies, together with copies of that party's witness statements, will make the detail of the nature of the case the other side has to meet obvious. This reduces the need for particulars in order to avoid being taken by surprise. This does not mean that pleadings are now superfluous. Pleadings are still required to mark out the parameters of the case that is being advanced by each party. In particular they are still critical to identify the issues and the extent of the dispute between the parties. What is important is that the pleadings should make clear the general nature of the case of the pleader."

McPhilemy was a libel action but we consider that the comments of Lord Woolf apply with equal, if not greater, force to proceedings in the less formal environment of the FTT.

81. Mr Scorey did not ask us to depart from the decision of the Upper Tribunal in *E Buyer*. Mr Scorey submitted that everything turned on the last sentence of [86(6)] in *E Buyer*. Prizeflex only relied on *E Buyer* for one proposition, namely that the allegation in this case was that Prizeflex had been dishonest. Where that is the case, the issue is how should that be pleaded and proved. Mr Scorey submitted that the allegation must be specifically alleged and adequately particularised which had not been done in this case. HMRC's case in relation to Prizeflex was that there was an orchestrated scheme and the overall purpose of all the transactions was to extract money from HMRC. In that type of fraud and if everyone is aware of contrivance then it involves dishonesty.

82. Mr Scorey accepted that Prizeflex understood the allegation that, absent dishonesty, the scheme could not work. It was plain that HMRC's case involved allegations that Mr Surana had acted dishonestly. Mr Scorey did not dispute that Prizeflex knew how the case was being put but he submitted that it was not clear what fraud was relied on and that, depending on the nature of the fraud, the facts relied on may differ. Cross-examination and legal submissions are determined by the factual context. The FTT did not discuss the nature of the underlying fraud at all in the Decision.

83. Mr Scorey stated that, in the FTT, HMRC had submitted that dishonesty may be the ultimate conclusion but that they did not need to go that far. The FTT had accepted that and Mr Scorey submitted that this was a fundamental error: the FTT were wrong to accept that HMRC could allege that matters involved dishonesty without specifying those matters fully. Mr Scorey submitted that HMRC had put their case very high and said that the fraud would not work unless Prizeflex was not an innocent dupe but was a knowing participant. He contended that there was no finding by the FTT in the Decision of the nature of the fraud and how it worked and, in the absence of such findings, the FTT were not entitled to make findings that Prizeflex actually knew that the transactions were connected to fraud. The FTT thought they could avoid dealing with dishonesty but created a muddle. Mr Scorey submitted that it was not possible to take [108] to [110] as sufficient as the prime objection remains (he accepted that grounds 5 and 6 might fall away but the others would not). In summary, Prizeflex's overarching submission was that the FTT had misunderstood their function. They did not appreciate the nature of fraud alleged and that they had to be satisfied that Mr Surana was dishonest.

84. In relation to Prizeflex's points on the nature of the fraud alleged, Mr Kinnear submitted that HMRC had fully pleaded an orchestrated contrived scheme and Prizeflex had accepted that to be the case. Mr Kinnear contended that there was evidence in relation to the other participants in the scheme such as transactional evidence including schedules of deals; FCIB banking evidence which showed that there was circularity in eight deals and that the remainder of the deals had similar features. In relation to the allegations of dishonesty, Mr Kinnear submitted that there was no need for the FTT to make a finding on it as the *Kittel* test does not require it.

85. In relation to the evidence in Prizeflex's appeal, Mr Scorey said that there were witness statements and evidence dealing with Prizeflex and the defaulters and evidence of the bank accounts with the FCIB used by the other participants (but not Prizeflex) but there was no evidence in relation to the other parties in the transaction chains because HMRC did not advance any case against the other participants. HMRC produced deal sheets for the FTT which identified the defaulter and Prizeflex as the broker but provided no evidence in relation to the buffers. Mr Scorey submitted that HMRC's case was that the fraud only worked if everyone was involved. He contended that the FTT could not carve out a case that it was sufficient that Prizeflex simply knew of the connection to the defaulter and they did not need to make findings in relation to the intermediaries. Mr Scorey submitted that it was not open to the FTT to make alternative findings or findings on the alternative case.

86. Mr Scorey also made submissions on the findings of fact by the FTT both generally and in ground 5, which we deal with below. Mr Scorey submitted that the FTT rejected HMRC's primary case that Prizeflex was a knowing participant with others in an orchestrated fraud in the last paragraph of [4(3)]. The reference to HMRC's case being based on "Prizeflex's knowledge of the fraud of others" showed that the FTT did not appreciate that the case involved allegations of dishonesty on the part of Prizeflex. He submitted that the FTT set off in the wrong direction. There was no explanation why the FTT rejected HMRC's primary case and was content to rely on fraud by the defaulter only.

87. We accept that [4(3)] could have been better worded but we do not accept that it shows that the FTT misunderstood or rejected HMRC's primary case. That case was set out by the FTT at [69] to [70]. It was that Prizeflex and all the participants knew that the transactions were fraudulent. That was the case that the FTT considered in [108] to [117]. In particular, the discussion of the absence of commerciality in [108] to [110] and the FTT's finding in [115] that Mr Surana knew that he was being rewarded for taking part in fraudulent transaction chains and was aware of more participants in the transactions shows that the FTT had HMRC's primary case in mind. In so far as this is inconsistent with the FTT's statement in [4(3)], we conclude that [4(3)] was badly worded but does not indicate any greater error.

88. Mr Scorey contended that the FTT relied on the admission in [3] in relation to the defaulting traders. The statement in [99] that there was no dispute between the parties that each of the 16 deals could be traced to a fraudulent trader was not a sufficient admission to establish HMRC's primary case. Mr Scorey also said that it was hard to understand the statement in [102] that the evidence of an HMRC officer that the deals were circular and contrived was not critical to the FTT's decision. The concession in relation to circularity was only partial and the issue of contrivance was not resolved by the FTT. The FTT stated in [102] that they had not treated the evidence of Mr Reardon

in relation to circularity and the contrived nature of the deals as critical but the evidence was not wholly disregarded. In [117(1)] the FTT referred to circularity and the orchestrated nature of the scheme but it is clear that the FTT did not accept HMRC's submission that the orchestration etc was evidence of Prizeflex's actual knowledge.

89. Mr Scorey accepted that [108] and [109] contained findings of primary fact by the FTT. Mr Scorey submitted, however, that the FTT made a logical leap when they concluded that the transactions in which Prizeflex was involved had features that were not consistent with legitimate commercial trading, such as that others were involved in the deception, because that did not necessarily involve findings of fraud by the others which went beyond what was actually found by the FTT. If the FTT found that Mr Surana could not explain the commercial negotiations surrounding the transactions, it does not necessarily entail a finding of fraud by other participants in the chain. In [108], however, the FTT referred to their view that Mr Surana could not provide any convincing commercial explanation for the transactions as the "most compelling evidence" that Prizeflex knew they were fraudulent. This must be viewed in the context of the FTT's finding, in [117(2)], that Mr Surana did not appear to be someone who would be duped.

90. Mr Scorey stated that, in [109], it is unclear whether the fraud referred to is the fraud that had been admitted, i.e. the fraud by the defaulter, or some other fraud. He contended that the FTT's discussion of the lack of commercial negotiations was only relevant if the FTT had in mind a larger fraud which the FTT had rejected at [4(3)]. Similarly, he submitted that, in the last sentence of [111], the finding that Mr Surana knew that the deals were fraudulent and was happy to participate in them was inconsistent with what the FTT had said in [4(3)]. Mr Scorey also suggested that it was unclear what the FTT was saying in [117(1)] about HMRC's primary case, which had been rejected in [4(3)]. In [117(1)], the FTT stated that HMRC's argument that the very orchestrated nature of the fraud meant that each participant must have known that the deals were connected to fraud was not a sufficient answer to the question of what Prizeflex actually knew as a participant in the chain. As we have already discussed, we do not accept that the FTT rejected HMRC's primary case in the last paragraph of [4(3)]. Accordingly, the FTT were not inconsistent or illogical in making the findings that they did in [108], [109], [111] and [117(1)]. Far from rejecting HMRC's primary case, we consider, reading the Decision as a whole, that they accepted it but it was not necessary for them to do so. The only fact that the FTT were required to determine, as required by the first limb of the *Kittel* test, was whether Prizeflex, through Mr Surana, knew that its transactions were connected to fraud.

91. Mr Scorey then referred to the "contributing factors" identified by the FTT in [116]. He said that the documentation was only relevant in relation to counterparties if they were participants in fraud otherwise it only showed commercial slippage. In [116(2)], the FTT stated that Mr Surana never dealt directly with a fraudulent trader (i.e. the person in the deal who failed to pay the VAT), which showed that the FTT did not consider that the counterparties were participants in the fraud. We do not accept that the penultimate sentence of [116(2)] shows that the FTT had rejected HMRC's primary case. It is part of a discussion of Mr Surana's attitude to due diligence. The FTT is stating that the fact that Prizeflex did not deal with the defaulters was not a reason for them to change their view that Mr Surana's attitude was not an adequate response to the possibility of Prizeflex's transactions being connected to fraud.

92. Mr Kinnear submitted that the FTT's conclusion in [100] was based on the application of the correct test. He stated that the FTT were correct to state, in [106], that it is not necessary for them to come to a conclusion on whether Mr Surana was dishonest because they were considering the *Kittel* test. Mr Kinnear submitted that Prizeflex's closing submissions showed that they were aware that HMRC were alleging that Mr Surana was involved in a criminal conspiracy. Mr Kinnear pointed out that, in [101], the FTT stated that they would set out their reasons in order of weight and submitted that [108] to [113] are the main findings on which the FTT based their conclusion that Prizeflex had actual knowledge. Mr Kinnear submitted that if a line is drawn after paragraphs 108 to 110 then that would be enough and the rest are merely additional factors which support the conclusion.

93. Central to the overarching submission and the first three grounds is how HMRC put their case. As Mr Scorey specifically acknowledged, this is not just a pleading point. It is clear from *McPhilemy* that what is required is that Prizeflex clearly understood the case that it had to face in the FTT. In our view, the allegations of the primary case and the alternative case were clear from the Amended Statement of Case, the evidence, the cross-examination and the legal submissions set out at [24] to [36] and [39] to [45] above. It is clear that HMRC put their primary case on the basis that this was an orchestrated and contrived scheme and Prizeflex understood that. There was no unfairness to Prizeflex in dealing with those matters. We do not accept that the FTT misunderstood the cases put by HMRC and Prizeflex. In our view, it is clear that Prizeflex was not only arguing that the fraud in this appeal was an acquisition fraud, i.e. HMRC's alternative case, but also made submissions on HMRC's primary case. For example, in its opening submissions, Prizeflex accepted that there was a contrived and orchestrated scheme but maintained that Prizeflex was a victim. In its closing submissions, Prizeflex accepted that there was a larger conspiracy, i.e. an orchestrated and contrived scheme. In any event, the FTT's task was to decide whether they were satisfied that HMRC had shown, on the balance of probabilities, that Prizeflex knew or ought to have known of the connection with fraud on the basis of the case set out in the pleadings and evidence. The particular type of fraud was irrelevant to that task.

94. Mr Scorey did not go so far as to submit that *Kittel* necessarily required dishonesty but said that everything depends on how the case is put. He argued that the FTT could not determine whether Prizeflex had knowledge of a connection with fraud unless the FTT had determined what the fraud was. We do not accept that submission. As Moses LJ observed in *Mobilx*, the test in *Kittel* should not be over refined. HMRC clearly advanced a case that Prizeflex, through Mr Surana, knew that the 16 transactions were connected with tax fraud and Prizeflex understood that case. As the Upper Tribunal in *E Buyer* observed about *Megtian*, that was plainly an allegation of conduct that was dishonest as we consider it was in this case. In making good their case, HMRC may show that Mr Surana was dishonest but that is not necessary to satisfy the *Kittel* test. The only fact that the FTT were required to determine, as required by the first limb of the *Kittel* test, was whether Prizeflex, through Mr Surana, knew that its transactions were connected to fraud. There was, moreover, no need for HMRC to prove that every person in the transaction chain was dishonest or that Prizeflex knew the full details of the fraudulent scheme. A participant may know more or less about the details of the fraud. It is not necessary to know every detail of a fraud in order to be a participant and, for the purposes of the *Kittel* test, it is only necessary to know of the connection with fraud. What HMRC were required to prove under the first limb of *Kittel* was that

Prizeflex knew that the transactions were connected with fraud. *Kittel* does not require HMRC to establish more than that. HMRC's case was an inferential case built on circumstantial evidence. Determining whether a person has actual knowledge is a question of fact. The FTT's task was to assess and evaluate the evidence. They did so and concluded that Mr Surana knew that deals 2 to 16 were connected with fraud.

95. Having discussed the submissions on the allegations of dishonesty and the nature of the fraud in the context of the Decision as a whole, we can now deal with Grounds 1 to 3 quite briefly.

96. The first ground of appeal is that the FTT misunderstood HMRC's case against Prizeflex and failed to appreciate that HMRC's case involved allegations of dishonesty. Mr Scorey submitted that these errors of approach impaired the fact-finding process and led to further errors identified in the other grounds. This first ground turns on paragraph [4(3)]. We have already discussed [4(3)] and stated our view that it does not show that the FTT misunderstood or rejected HMRC's primary case which was clearly set out by the FTT at [69] to [70]. Accordingly, we reject this ground of appeal.

97. We can deal with the second and third ground together. The second ground is that the FTT erred in allowing HMRC to contend that Prizeflex, through its director Mr Nishel Surana, knew that the transactions were contrived and/or connected to fraud without specifically alleging dishonesty. Ground 3 is that the FTT erred in rejecting Prizeflex's complaints about lack of particularity in the pleadings. We have already stated (and we understand Prizeflex to accept) that dishonesty is not a requirement of either limb of the *Kittel* test but that establishing the first limb of the *Kittel* test may also show that there has been dishonest conduct. Even in that case, we do not consider that HMRC are required to use the word 'dishonest' provided that the case asserted and the conduct relied on are clearly set out in the pleadings and evidence. In this case, as we have discussed, there was no suggestion that Prizeflex was not fully aware of the case that it faced. It follows that there is no substance in the argument that the pleadings lacked particularity. We also reject these grounds.

98. We also indicated that, after considering Mr Scorey's submissions individually, we would stand back and ask ourselves whether any of the points raised, taken individually or in combination, cause us to have concerns about the findings of fact made by the FTT and/or the fairness of the procedure by which those findings were arrived at. We conclude:

(1) The case being put by HMRC was made quite clear to Prizeflex;

(2) HMRC's case was clearly put in the cross-examination of Mr Surana and he had a full opportunity to explain his position as to his involvement and his state of mind;

(3) The central question for the FTT was whether Mr Surana knew or ought to have known that the transactions were connected to fraud;

(4) The FTT made their findings of fact, based on all of the evidence, that Mr Surana did know of the connection to fraud in relation to deals 2 to 16 and ought to have known of the connection to fraud in relation to deal 1;

(5) Of central importance to the FTT's decision was its assessment of the evidence given by Mr Surana;

(6) The FTT did not accept Mr Surana's evidence on the question of his knowledge; despite his denials when cross-examined, they concluded that he knew of the connection to fraud in relation to deals 2 to 16;

(7) Subject to the points which we will separately consider under Grounds 5 and 6, those findings of fact answer the central question which the FTT had to decide;

(8) There was nothing procedurally unfair in relation to the investigation by the FTT of the central question before them.

Ground 4 – Evidence of character

99. Ground 4 of Prizeflex's grounds of appeal is based on the statement made by the FTT in [106] where they said: "The Appellant spent some time discussing Mr Surana's character, but we do not consider that this is relevant to this appeal."

100. Mr Scorey submitted to us that the FTT erred in law in concluding that evidence and submissions relating to Mr Nishel Surana's character were not relevant to issues in the appeal to the FTT, when the case against him necessarily impugned his honesty. He contended that, despite time having been spent on it, [106] showed that the evidence of Mr Surana's character was not addressed at all and it was impossible to say what the outcome of the appeal would have been if the evidence had been addressed. At the hearing before us, Mr Kinnear accepted that the second sentence of [106] contained an error in that the evidence of Mr Surana's character was admissible and was therefore legally relevant to the issue before the FTT. Mr Kinnear's concession was based on the position in criminal trials where good character evidence in relation to the accused is relevant both as to the propensity to commit the offence and as to the credibility of any evidence given by the accused.

101. We have already explained that it is not clear to us precisely what the FTT meant by the second sentence of [106]. Before the FTT, it appears to have been accepted that Prizeflex was entitled to lead evidence of good character in relation to Mr Surana. HMRC did not submit that such evidence was inadmissible. Against that background, it seems unlikely that the FTT was giving a legal ruling that good character evidence was inadmissible. It seems to us to be much more likely that the FTT was saying that the general evidence they had been given as to Mr Surana's character was not material when they considered the specific questions as to whether Mr Surana knew or ought to have known that the transactions were connected to fraud.

102. If the FTT were saying that the good character evidence, although legally admissible (as everyone then accepted), had no real part to play in their assessment of whether Mr Surana knew of the connection with fraud, we consider that that finding would have been open to them. We have ourselves considered what the evidence as to character in this case amounted to.

103. In his second witness statement, Mr Surana stated that he took HMRC's case as a slur on his reputation, which he vehemently denied. In his examination in chief, Mr Surana gave evidence of his business experience. He was invited to comment on HMRC's assertion that he had been "thoroughly dishonest" and he said that that assertion had not been made at the time of the transactions. He was then asked whether he was dishonestly involved in the relevant transactions. He replied that he was not. When cross-examined, he maintained that he was innocent and it seemed that he was an

innocent dupe. Prizeflex called as a witness a Mr Raithatha who was the general manager and bookkeeper at Prizeflex. In his witness statement, Mr Raithatha said that he had known Mr Surana for a long time and he knew him to be honest and that he was very honest. In his examination in chief, Mr Raithatha said that Mr Surana was "a good character, honest, same as father" and that he had not known him to have done anything dishonest. He also stated that he had not known Mr Surana's father to have done anything dishonest.

104. Having considered that evidence as to character, we do not see how it had any real part to play in determining what findings of fact to make as to whether Mr Surana knew that the transactions were connected to fraud. It was plainly put to Mr Surana that he did know of the connection. He was asked to give his explanation for a number of features of the transactions. The FTT held that he was not able to explain those features. They concluded on the evidence that he knew of the connection to fraud. They did not accept his evidence to the contrary. In view of that assessment of Mr Surana's reliability as a witness, it is clear that no weight could be given to his own evidence as to his honesty. Mr Raithatha's evidence was of the most general nature and could not be given any weight.

105. At this point, we will consider what we would do if we were to hold: (1) that the second sentence of [106] amounted to a ruling that good character evidence in relation to Mr Surana was not admissible in evidence: and (2) that such a ruling was wrong in law. In those circumstances, we would have to consider whether: (1) to remit the matter to a differently constituted tribunal to hear the appeal afresh; or (2) remit the matter to the same FTT to reconsider their findings after directing themselves that the good character evidence in relation to Mr Surana was legally admissible; or (3) to decide for ourselves whether the evidence as to character in this case should be given any weight. We take that view that the ultimate decision on this point would not be an easy one but we would probably reach the conclusion that it was open to us to take the third of these courses, to determine that the character evidence in this case had no weight so that it was unnecessary to remit the matter to a tribunal, whether constituted as before, or differently constituted.

106. We have also considered how matters would stand if we did not feel able to reach the conclusions in the last paragraph. For this purpose, we have fully considered the question as to whether the evidence as to character in this case was legally admissible in evidence.

107. Following the hearing and having considered the discussion of good character evidence in civil proceedings in *Phipson on Evidence 18th edition* at paragraph 18-26, we asked both parties to provide written submissions on the admissibility of good character evidence in this case.

108. For Prizeflex, Mr Scorey and Mr Cribb accepted that, under the rules of evidence applicable in ordinary civil proceedings, evidence of good character is inadmissible but they submitted that was not the position in this case for the following reasons:

> (1) the strict rules of evidence do not apply to the proceedings in the FTT because rule 15(2)(a) of the FTT Rules provides that the FTT may admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom;

(2) the rationale which underpins the exclusionary rule in civil cases, as explained by Martin B in *Attorney General v Radloff* (1854) 10 Exch. 84 ('*Radloff*') at 97, does not apply in this case where allegations of dishonesty were advanced; and

(3) the FTT should have considered the evidence of Mr Surana's good character because, by analogy with cases concerning disciplinary proceedings instigated by the Law Society involving allegations of dishonesty such as *Bryant v The Law Society* [2009] 1 W.L.R. 163 ('*Bryant'*), it was legally relevant to the issue before the FTT.

109. For HMRC, Mr Kinnear and Mr Watkinson submitted that:

(1) in ordinary civil litigation, good character evidence is not admissible because it is not relevant;

(2) in criminal proceedings and disciplinary proceedings where proof of subjective dishonesty is required, good character evidence is admissible as relevant to the issue of dishonesty;

(3) in the present context, where it is alleged that a party knew a transaction was connected with fraud, it is not necessary to prove subjective dishonesty; and

(4) in the present context, where it is alleged that a party ought to have known that a transaction was connected to fraud, it is not necessary to prove any kind of dishonesty.

110. The reference to "subjective dishonesty" is a reference to the test as to dishonesty in *R v Ghosh [1982] 1 QB 1053* rather than an objective test as to dishonesty as in *Barlow Clowes International Ltd v Eurotrust International Ltd* [2006] 1 WLR 1476.

111. Although we were not addressed in any detail on the role of good character evidence in criminal cases, we have considered *R v Aziz* [1996] 1 AC 41 and the recent decision in *R v Hunter* [2016] 2 All ER 1021. *R v Aziz* concerned the direction to be given as to good character in a criminal case. It confirms that evidence of good character may go to both the propensity to commit the alleged offence and as to credibility. As it happens, the alleged offence in that case was the fraudulent evasion of VAT by the creation of false invoices. The whole question of directions as to good character was re-considered in *R v Hunter*. From our reading of that decision, it does not appear to us that in criminal cases good character directions are confined to cases of subjective dishonesty, or even cases of dishonesty generally.

112. As to civil proceedings, the text books appear to be clear that, in general, good character evidence is not admissible: see *Phipson on Evidence, 18th ed. at para 18-26* and *Cross & Tapper on Evidence, 11th ed.* at pp 353-354. In *Halsbury's Laws, 5th ed. 2015*, the law is described in a similar way save that it is stated that evidence of reputation is relevant in a defamation case. We note, however, that *Cross & Tapper* suggests that if the credibility of a witness is attacked, then evidence of good character could be given in rebuttal. If that is right, such evidence would be relevant only to credibility and not to propensity. In the present case, if evidence as to Mr Surana's character were admissible only for the purpose of an attempt to restore his credibility, it would have been open to the FTT, as explained above, to hold that they did not give that evidence any weight when deciding on his credibility.

113. *Phipson on Evidence* cites *Radloff* and mentions *A.G. v Bowman* (1791) 1 Bos & P 532 (note) in a footnote. In both cases, it was held that evidence as to good character is not admissible in civil proceedings. In *Radloff*, the issue was whether Mr Radloff was liable for a penalty for smuggling in breach of the customs laws and in *Bowman* the issue was whether Mr Bowman had kept false weights and had offered to corrupt an officer. In *Bowman*, Chief Baron Eyre stated that evidence as to good character would not be admissible in a charge of "fraud upon the Excise and Custom-House laws". These cases provide no support for the suggestion that good character evidence is admissible in a civil case where the issue involves dishonesty.

114. *Radloff* and *Bowman* are cases of some antiquity. However, more recent cases continue to say that good character evidence is not admissible in civil proceedings whether on the issue of propensity or of credibility: see the comments of Buxton LJ in *Magdouch v Rmiki* [1999] EWCA Civ 1572. The survival of Martin B's dicta in *Radloff* as a clear statement of the law and practice was also endorsed by Teare J in *Stokors SA & Ors v IG Markets Ltd* [2012] EWHC 2504 (Comm). Teare J held at [28]:

> "In my judgment, the court, certainly a court of first instance, must follow the established practice set out in Phipson and other text books with regard to civil proceedings which is that evidence of character and general reputation for honesty is not admissible. [Counsel for the defendant] also submitted that this evidence was relevant to the element of knowledge which is alleged by the claimants. In particular, blind eye or Nelsonian knowledge. I am not at all persuaded that evidence of general reputation and honest conduct is relevant to questions of knowledge. For those reasons I must accede to the claimant's application to strike out the witness evidence going to character."

115. Mr Scorey referred us to the position in the Solicitors Disciplinary Tribunal in relation to allegations of dishonesty against a solicitor. The decisions in *Bryant* and *Donkin v Law Society* [2007] EWHC 414 (Admin) show that an allegation of dishonesty against a solicitor is to be judged by the tribunal by asking whether there was subjective dishonesty, as in a criminal charge involving dishonesty (*R v Ghosh*), and that evidence as to the good character of the solicitor is admissible both as to the propensity to commit the alleged conduct and credibility. *Bryant* was cited to Teare J in *Stokors SA v IG Markets Ltd* where the allegation was of knowing assistance of a breach of trust and knowing receipt of trust monies and the allegations involved allegations of dishonesty, objectively considered in accordance with *Barlow Clowes International Ltd v Eurotrust International Ltd*. Teare J held that in a civil case, even where there was an allegation of dishonesty, the court should apply the principle in *Radloff* and not the approach of the Solicitors Disciplinary Tribunal.

116. As we have explained earlier in this decision, the legal question for the FTT was whether Mr Surana knew or ought to have known that the transactions were connected to fraud. The legal test does not involve an ingredient of dishonesty and certainly not a requirement to show subjective dishonesty. The proceedings before the FTT were civil proceedings. We consider that the ordinary rules of evidence which apply in civil cases render good character inadmissible in such a case.

117. Our conclusion that evidence of Mr Surana's good character was not admissible does not necessarily determine the issue raised by this ground of appeal. Mr Scorey and Mr Cribb pointed to rule 15(2)(a) of the FTT Rules which provides that the FTT may admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom. Their written submissions argued that the evidence of Mr Surana's

character was relevant to the issues in the appeal, in particular HMRC's allegations that Mr Surana, and thus Prizeflex, was not an innocent dupe. Mr Kinnear and Mr Watkinson submit that rule 15(2)(a) does not, however, allow the FTT to admit evidence that is not relevant and the evidence about Mr Surana's character was not relevant to the matters before the FTT. Prizeflex went so far as to submit that in view of the way in which HMRC put their case against Prizeflex, HMRC should be understood to be asserting that this was a case of subjective dishonesty on the part of Mr Surana. We do not agree. We accept that HMRC's case that Mr Surana knew of the connection to fraud amounted in substance to the assertion that Mr Surana was dishonest. We do not, however, think that it can be read as necessarily involving the further assertion that Mr Surana knew that he was dishonest. The question whether Mr Surana knew that he was dishonest is a wholly unnecessary area of inquiry. The FTT rightly did not enter into that area of inquiry. If the suggested good character evidence is irrelevant in relation to the case which Mr Surana had to answer, namely that he knew the transactions were connected to fraud, it would be wholly inappropriate to admit evidence as to his state of mind in order to deal with an issue which he did not have to deal with, namely whether he knew that he was dishonest.

118. In any event, rule 15(2)(a) confers a discretion on the FTT. The rule does not justify, much less require, a wholesale departure from the rules of evidence. It can allow a degree of flexibility in relation to rules of evidence, such as hearsay, which is appropriate given the nature of appeals before the FTT and the need to give effect to the overriding objective in the FTT Rules. The established authorities state that there are good reasons for the long-established practice of not admitting evidence of good character in civil proceedings and the FTT should not lightly cast that practice aside. If the FTT had actually decided in this case not to exercise a discretion to admit the evidence of Mr Surana's good character in this case, that decision would not involve any error of law.

119. In these circumstances, even if the second sentence of [106] is to be read as Prizeflex contended, which we doubt, it did not involve an error of law on the part of the FTT. Further, if the FTT had committed an error of law by refusing to admit character evidence, we think it likely that we would have dismissed the appeal on this point on the ground that the only possible answer was that the character evidence in this case should be given no weight. We therefore dismiss the appeal in relation to Ground 4.

Ground 5 – Conclusions not supported by findings of fact

120. In ground five, Mr Scorey submitted that the facts found by the FTT did not support the conclusion or permit the inference that Prizeflex, through Mr Surana, knew that the transactions were connected with fraud. Mr Scorey referred to five specific findings by the FTT. In our view, even if they are validly made, the five criticisms fail to undermine the findings of fact by the FTT in [108] to [110] which were the reasons on which the FTT placed most weight in reaching their conclusions in [100]. In any event, we reject all five criticisms.

121. Mr Scorey criticised the FTT's statement, in [111], that the transactions had the hallmarks of fraudulent deals and their reliance on the existence of such hallmarks in finding that Mr Surana knew that the deals were fraudulent. Mr Scorey submitted that the FTT made no findings as to what features of the transactions constituted hallmarks of fraud which should have alerted Mr Surana that the transactions were fraudulent. Mr

Scorey contrasted the FTT's approach in this case with the approach of the FTT in *Edgeskill Ltd v HMRC* [2011] UKFTT 393 (TC) where the FTT had made detailed findings as to what were the indicia of fraud in the facts which it called hallmarks of fraud as a shorthand. Mr Scorey said that using the phrase "hallmarks of fraud" was not a substitute for analysis in Prizeflex's appeal. We consider that this criticism is unfounded. The FTT was referred to *Edgeskill* (see [70]) and, although they do not refer specifically to the paragraph ([56]) in that decision which describes the hallmarks of fraud, we have no doubt that the FTT had it in mind. It is clear that the phrase "hallmarks of fraud" was used by HMRC and adopted by Mr Farrell QC in his submissions on behalf of Prizeflex (see [66] and [75]). More significantly, the FTT set out some matters that they considered to be hallmarks of fraud in this case at [122], when discussing deal 1. The matters mentioned in [122] are set out more fully in [25] where the FTT described the features of the transactions that made HMRC suspicious. Reading all of those passages, rather than taking [111] alone as Mr Scorey would have us do, it is clear what the FTT meant by "hallmarks of fraud" in [111] and, further, we have no doubt that it was also clear to Prizeflex.

122. In [112], the FTT found that there would not (although that important word is actually missing from [112], both parties accepted that it was intended) have been a large demand for those models of phones and certainly not at the margins made by Prizeflex or for all of the deals. Mr Scorey submitted that it was not open to the FTT to make findings in relation to the nature of the market in [112] when there was no evidence about it and the FTT had disregarded Mr Fletcher's evidence about the grey market in mobile phones. We do not think that there is anything in this criticism. It is clear from [103] that the FTT did not simply disregard Mr Fletcher's evidence but did not rely on it to any great extent. Further, in [112], the FTT state that their conclusion about the state of the market for the phones in the relevant deals was based on the evidence of the serial numbers and release dates of the phones. Such evidence was, in our view, sufficient to enable them to conclude, as they did, that Mr Surana's suggestion that there was an explosive growth in the mobile phone business was unconvincing.

123. Mr Scorey contended that the actions of Prizeflex identified by the FTT in [114] as indicators of knowledge of fraud were not sufficient, either singly or together, to support that conclusion or allow knowledge of the connection with fraud to be inferred. Mr Scorey's criticism overlooks the statement by the FTT in [114] that the actions only suggested knowledge of fraud when combined with the actions set out in the preceding paragraphs i.e. [108] to [113]. The FTT had already stated, in [101], that not only would they set out their reasons in order of weight but they would make clear where their conclusions were based on a combination of factors. The points in [114] are such factors. We agree that, viewed individually, the three actions identified in [114] would not support a finding of knowledge of a connection with fraud. Even taking those three factors together might not be enough but, when viewed in the context of the facts described in [108] to [113], the actions can be seen as supporting a conclusion that Prizeflex was knowingly participating in fraud.

124. Mr Scorey also criticised the FTT for concluding, in [115], that Prizeflex's willingness to wait for VAT repayments indicated that Mr Surana was aware of other participants in the transactions beyond his immediate suppliers and purchasers. We consider that the FTT were entitled to make that finding. It is clear from [115] that Mr Surana's evidence was that, by waiting for its VAT repayment, Prizeflex provided cash flow to its suppliers which others might not be willing to provide. In our opinion, the

FTT was saying no more in [115] than that Mr Surana's evidence suggested that he was aware that there were other persons, i.e. those who were not willing to provide cash flow to his suppliers, involved in the transactions.

125. Mr Scorey's final criticism was that the findings of fact at [89] to [98] were rather thin and do not support the FTT's inferences and conclusions. Mr Scorey submitted that there were no findings of wrongdoing against anybody. We do not accept this general and non-specific criticism. We see no reason why, having fully described the evidence at [14] to [56], the FTT should not state its findings in relation to that evidence succinctly.

Ground 6 - Admission of evidence of loan

126. Mr Scorey stated that the issue of the loan was first raised in a witness statement of Mr Reardon, HMRC officer, dated 25 April 2013. It concerned a loan of £150,000 made to Prizeflex on 1 June 2006 by Mr Mohammed Shabir Patel, a director of First Solutions (England) Ltd and Mobile Solutions, supplier to one of Prizeflex's suppliers. No plea relied on the fact of the loan. The transcript showed that HMRC relied on the evidence of the loan to undermine the credibility of Mr Surana and, therefore, Prizeflex's whole case (see [40] above). Mr Scorey contended that the FTT rejected Prizeflex's objection to the late introduction of the evidence and, in doing so, erred as they failed to have regard to the need for primary facts to be pleaded. Mr Scorey submitted that if it were a pure case management matter then it would be a matter for the FTT and not for the Upper Tribunal but it went further than that because it related to an allegation of fraud. Prizeflex was prejudiced by the introduction of the loan evidence not only because the main witness for Prizeflex involved in the making of this loan, Mr Surana senior, had died but also because Mr Patel could not be contacted when the witness statement was produced in 2013.

127. HMRC accepted that the evidence of the loan was not particularised in the Amended Statement of Case. Mr Kinnear submitted that the FTT's decision not to exclude the evidence was a case management decision and provided we are satisfied, as he submits we should be, that the FTT applied the correct principles, took into account matters which should have been taken into account and left out of account matters that are irrelevant, then we should not interfere with it unless we are satisfied that it is so plainly wrong that it must be regarded as falling outside the generous ambit of discretion entrusted to the FTT in such matters (see *Goldman Sachs International and another v HMRC* [2009] UKUT 90 (TCC)). Mr Kinnear also pointed out that, in [117(3)], the FTT said that they had "not relied on this [evidence of the loan] as a significant piece of evidence" and, in the decision refusing permission to appeal, the FTT said that "no weight was given to this evidence". In relation to Mr Kinnear's last point, Mr Scorey submitted that the permission to appeal decision was an attempt to retract the clear statement in the Decision.

128. It is not disputed that HMRC did not properly plead the details of the loan and how it was relied on in their Amended Statement of Case. However, it is not necessary to plead every fact provided that sufficient facts are pleaded to enable the appellant to understand the case that is made against him. Further, the loan was referred to in Mr Reardon's witness statement and in HMRC's written opening submissions served 28 days before the hearing. In our view, it was a matter of case management for the FTT as to whether pleadings should be amended and/or the evidence of the loan admitted. In the circumstances of this case, we do not consider that the FTT erred or strayed outside

the ambit of their discretion in not excluding the evidence. We also derive some comfort from the fact that the FTT only referred to the loan in the section of the Decision ([117]) dealing with minor factors, i.e. the evidence that carried the least weight, and stated that they had not relied on it as a significant piece of evidence. We regard the statement in the decision on the application for permission to appeal that the FTT gave no weight to evidence in relation to the loan as an attempt to clarify the passage in [117(3)] rather than, as Mr Scorey would have it, a retraction. Finally, we record our view that we cannot see that there was anything procedurally unfair in the way in which the question of the loan was dealt with by the FTT.

Ground 8 - Deal 1

129. In relation to Ground 8 which concerned whether Prizeflex ought to have known that deal 1 was connected to fraud, Mr Scorey submitted that the FTT applied the wrong test in [122] where they referred to certain "hallmarks of fraud". Mr Scorey submitted that there must be evidence that shows that the transactions were connected to fraud. The only "hallmarks" mentioned were importation patterns, type of phones imported and the margin achieved on the deal. Mr Scorey submitted that the FTT's conclusion simply did not follow from the matters which it set out and on which it purported to rely.

130. We have already discussed the FTT's reliance on "hallmarks of fraud" and rejected Mr Scorey's criticism of it in this case (see [121] above). The FTT set out the correct test from *Mobilx* in [122] where they stated that they had concluded that Mr Surana should have known that the only reasonable explanation for the unusual features of the deal was that it was connected with fraud. Further, [119] shows that the FTT approached the application of that test to deal 1 correctly. In the circumstances, we do not accept that [118] – [123] show any error by the FTT.

Disposition

131. For the reasons given above, Prizeflex's appeal against the Decision is dismissed.

Costs

132. Any application for costs in relation to this appeal must be made in writing within one month after the date of release of this decision. As any order in respect of costs will, if not agreed, be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

The Hon Mr Justice Morgan

Judge Greg Sinfield

Release date: 17 October 2016