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UT (Tax & Chancery) Case Number: UT/2021/000183

Upper Tribunal
(Tax and Chancery Chamber)

Hearing venue: Royal Courts of Justice, London

Heard on: 7 September 2022
Judgment date: 22 September 2022

VAT – Whether First-tier Tribunal followed correct approach when denying input tax credit under Kittel principles – yes – whether decision perverse – no – appeal dismissed

Before

JUDGE JONATHAN RICHARDS
JUDGE NICHOLAS ALEKSANDER

Between

NORTHSIDE FLEET LIMITED

Appellant

and

THE COMMISSIONERS FOR HM REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Howard Watkinson, Counsel, instructed by ASW Legal Limited

For the Respondents: Joanna Vicary, Counsel, instructed by General Counsel and Solicitor for HM Revenue & Customs

DECISION

1. The appellant company ("Northside"), at material times, carried on a business involving the sale of used cars. Its sole director and shareholder was Mr Alan Harford. By a decision released on 11 August 2021 (the "Decision") of the First-tier Tribunal (Tax Chamber) (the "FTT"), the FTT upheld HMRC's decision to refuse Northside's claims to recover input tax on purchases of certain vehicles in its VAT periods 01/17 to 07/17. Also, by the Decision the FTT allowed Northside's appeal against HMRC's decisions that certain vehicles sold in those VAT periods should be standard-rated for VAT purposes, rather than zero-rated as Northside had claimed. With the permission of the FTT, Northside appeals against the Decision as relating to the denial of input tax credit. Neither party seeks to disturb the FTT's conclusions on the zero-rating issue.

2. In the remainder of this decision, references to numbers in square brackets are to paragraphs of the Decision unless we specify otherwise.

The Decision

Background

3. HMRC justified their decision to deny Northside credit for input tax by reference to the judgment of the Court of Justice of the European Union in *Axel Kittel v Belgian State and Belgian State v Recolta Recycling SPRL* (C-439/04 and C-440/04) ("*Kittel*"). Under the *Kittel* principle, Northside's entitlement to input tax credit would be denied if all of the following conditions were met:

(1) HMRC had suffered a loss of VAT.

(2) That loss resulted from fraudulent evasion.

(3) Northside's purchases of vehicles were connected with that fraudulent evasion.

(4) Northside knew, or should have known, that its purchases were so connected.

4. Northside's relevant purchases of vehicles (the "disputed transactions") were from four suppliers, defined at [30] as "Mohawk", "Instant", "KWD" and "DLL". The identity of these suppliers, and the persons with whom Northside dealt when arranging purchases of vehicles from them was of some significance in the proceedings and can be summarised as follows:

(1) Mohawk was the trading name of a business carried on by a Mr Joseph Murdock as sole trader. Northside dealt with Mr Murdock in relation to vehicle purchases.

(2) Instant was a private limited company. Northside dealt with a Mr Maguire, who was a director of Instant, in relation to vehicle purchases.

(3) KWD was a private limited company. The evidence of Mr Harford was that he could not remember who he dealt with at KWD.

(4) DLL was a private limited company. Mr Harford's evidence was that he dealt with a Mr Paul Donnelly at DLL. However, the FTT concluded at [65(5)] and [112] that Mr Donnelly had no authority to represent DLL at relevant times in 2017 since he had ceased being a director of DLL and had sold all of his shares to a Ms Seanan McNulty in 2016. HMRC invite us to read [65(5)] and [112] as finding that Mr Harford was lying when he said that he had dealings with Mr Donnelly and that, in fact, he was dealing with someone else. However, in our judgment, the FTT's findings were more nuanced. It certainly found that Mr Donnelly was not "representing" DLL in 2017. However, at [112] the FTT said only that this conclusion admitted of two possibilities: either that Mr Harford did have dealings with Mr Donnelly, but in those dealings Mr Donnelly had no authority to

represent DLL, or that Mr Harford did not deal with Mr Donnelly at all but in fact dealt with someone else who did have authority to represent DLL. It did not decide between these two competing possibilities. The FTT made detailed criticisms of Mr Harford's evidence at [57] and [58]. If it had concluded that he was lying about his dealings with Mr Donnelly, it would have said so expressly rather than simply commenting, at [58], that Mr Harford's claim to be dealing with Mr Donnelly was "strange".

5. Northside accepted that limb (1) of the *Kittel* test was satisfied by reference to purchases of vehicles from these four suppliers ([33]). It put HMRC to proof on limb (2). The FTT found at [72], [75], [78] and [84] that limb (2) was satisfied because each of these suppliers fraudulently defaulted on their obligations to pay output VAT. Since neither party seeks to challenge that conclusion, we need say little about the process of reasoning that led the FTT it.

6. Northside accepted (see [36]) that, to the extent that limb (2) of the *Kittel* test was satisfied, so was limb (3).

7. Northside's challenge to the Decision is solely to the FTT's conclusion on limb (4). More specifically, since both sides are content to accept the FTT's conclusion, at [104], that Northside did not have actual knowledge that its purchases were connected with fraudulent evasion of VAT, the challenge is to the FTT's conclusion that Northside "should have known" of such a connection.

The FTT's self-direction as to the law on "should have known"

8. Both parties accept the FTT's statement of the applicable law at [10] to [20] was correct. In those paragraphs, the FTT concluded, so far as material for present purposes that:

(1) The burden was on HMRC to establish that Northside had the necessary means of knowledge ([34]).

(2) The question whether Northside "should have known" that its transactions were connected with fraudulent evasion of VAT, or put another way, whether it had "constructive knowledge" of that fact, was identical to the question whether the only reasonable explanation for those transactions was that they were connected with fraud ([19]). (That summary is something of a shorthand. Both parties were agreed before us that the correct legal test, set out in *Kittel*, is whether Northside "should have known" that its transactions were connected with fraud. HMRC could establish that the "should have known" test was met by establishing that the only reasonable explanation for the transactions was a connection with fraud, but that was not the only way in which they could satisfy the test. However, nothing turns on this point because HMRC were content, in the FTT proceedings to stand or fall by reference to the question of "only reasonable explanation" and Northside approached the proceedings in the same way).

(3) It would not be enough for HMRC to show that Northside should have known that it was running the risk that it might be taking part in a transaction connected with fraud, or even that it was taking part in a transaction that was likely to be connected with fraud. Rather, HMRC had to establish that the facts must be such that the only reasonable explanation for the transactions was that they were connected with fraud ([15] and [20(4)]).

(4) It was relevant to consider the extent to which Northside performed appropriate due diligence. However, if Northside had not performed sufficient due diligence, that was not the end of the matter. If even an appropriate level of due diligence would not have revealed the connection with fraud, Northside would not have the necessary means of knowledge ([20(1)] and [20(2)]).

(5) The FTT should not be too focused on the question of due diligence without taking into account obvious inferences that should be drawn from the circumstances as a whole ([18]).

(6) In determining Northside's means of knowledge, it was necessary to consider the totality of the evidence and not examine each factor in a transaction in a piecemeal way ([20(5)]).

The FTT's findings of primary fact

9. Neither party challenges any of the FTT's findings of primary fact. We will not seek to summarise all of those primary findings, but simply set out the key findings that are necessary to understand the FTT's conclusion and the challenges to it.

10. Before setting out aspects of the FTT's detailed findings, it is appropriate to put those in context. Over the past several years, the courts and tribunals have dealt with many cases of "missing trader" or "MTIC" fraud. Not infrequently such cases have involved lengthy chains of back-to-back transactions in high value, but commoditised goods (such as mobile phones or computer chips), culminating in a sale to a "broker" who exports the goods and claims a VAT repayment. In challenging the broker's entitlement to input tax credit, HMRC will frequently point to the contrived nature of the transactions, the predictable profit, achieved without negotiation and for little effort, and failures to take ordinary commercial measures such as inspecting or insuring the goods in support of an argument that the trader either knew, or should have known, that the transactions were connected with fraud. The FTT recognised that this case was very different. It found that the evidence strongly suggested that Northside's purchases of vehicles were preceded by commercial negotiations ([106(3)]). It found that there was nothing incongruous about the insurance arrangements applicable to vehicles it purchased ([106(6)]). It found ([110]) that the disputed transactions "resembled in many ways the purchases which the Appellant made from its large company suppliers" that were unconnected with fraud.

11. Northside was incorporated on 5 December 2011 and registered for VAT with effect from 1 April 2012. Mr Harford was, at material times, Northside's sole shareholder and director. Northside appointed accountants ("SB&P") to manage its VAT affairs and was subjected to periodic VAT checks by HMRC. From time to time, those VAT checks revealed errors in Northside's VAT compliance, but until a letter dated 27 April 2016, HMRC did not raise the possibility of becoming connected with VAT fraud as an issue with Northside.

12. HMRC's letter of 27 April 2016 warned Northside in general terms of the possibility of becoming jointly and severally liable for VAT fraud perpetrated by customers ([48(8)]). On 20 October 2016, there was a meeting between HMRC, Mr Harford and SB&P to check the validity of certain transactions between Northside and a company called David McMahon Limited. At that meeting, Mr Harford confirmed that Northside purchased vehicles from a company called MCM Sales Limited ("MCM") and dealt with a Mr David McMahon at MCM ([48(9)]).

13. On 5 January 2017, HMRC wrote to Mr Harford (the "tax loss letter"). That letter notified Mr Harford that purchases of vehicles that Northside had made from MCM in VAT periods from 06/16 to 09/16 had been linked with fraudulent transaction chains ([48(10)]). The tax loss letter warned that input tax recovery could be restricted if Northside knew, or should have known, that purchases were connected with fraudulent VAT evasion and advised that Northside should satisfy itself that it was carrying out sufficient due diligence on its suppliers and customers to avoid that risk. A copy of HMRC's VAT leaflet PN 726 was provided which set out some examples of the sort of checks HMRC considered traders might wish to make. Mr Harford saw leaflet PN 726 and there were further

discussions between SB&P and HMRC as to the due diligence that Northside could and should undertake. The FTT found that HMRC's Officer Lowth specifically told Mr Harford that he should visit the business premises of his suppliers rather than simply meeting them in coffee shops, rejecting his contrary evidence that he was simply told in general terms that he needed to improve his due diligence with HMRC making no suggestions how to do so ([65(6)(b)]).

14. Despite HMRC's warnings as to the importance of checks on suppliers, Northside performed relatively few such checks. Mr Harford did not think that the kind of checks set out in PN 726 were necessary, because PN 726 dealt with a different kind of business ([54(4)]). He said that the recent incorporation of some of his suppliers did not trouble him because the individuals with whom he dealt seemed to have a good knowledge of the used car market. Northside obtained some verification of the identity of Instant, KWD and Mohawk ([48]), but the FTT concluded that this due diligence was inadequate, describing it as not "rudimentary" ([112]) and not "appropriate" ([110(11)]).

15. Instant was incorporated on 2 March 2016 ([56(3)]), KWD was incorporated on 22 June 2016 ([57(2)]) and DLL was incorporated on 27 October 2015 ([58(2)]). Mohawk was the trading name of an individual (Mr Murdock) who successfully applied to be registered for VAT on 25 November 2016, with that registration backdated to 6 April 2016 ([55(1) and [55(2)]). Therefore, the FTT concluded that Northside made the relevant purchases of vehicles from suppliers who were new businesses ([110(1)]).

16. Companies House records revealed some suggestions of a connection between two of the companies (Instant and KWD) both to each other and to Mr David McMahon who was involved with MCM, the company that was referred to in the tax loss letter as having been linked with fraudulent chains of transactions. In particular:

> (1) Mr David McMahon was a director of Instant between 16 November 2016 and 1 January 2017, although his resignation as director was not notified to Companies House until 19 April 2017 ([50(4)(b)] and [50(4)(d)]). Northside had argued that the director of Instant might be a different David McMahon from the director of MCM, but the FTT rejected that argument at [65(4)] and [75].
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> (2) The Companies House filing recording that Mr McMahon was a director of Instant gave his address as 72 Bardsay Road in Liverpool. That was also the registered office of both Instant and KWD for a period ([50(4)(b)], [50(4)(e)], [50(8)(b)]).
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> (3) A Mr Seamus Maguire was a director of Instant between 1 September 2016 and 16 November 2016. He was also a director of KWD from 13 July 2016 and the holder of 100% of KWD's shares between 9 November 2016 and 11 March 2017 ([50(4)(b)], [50(8)(a)] and [50(8)(i)]). Mr Seamus Maguire's address was shown in filings for both KWD and Instant as 72 Bardsay Road.

17. The FTT found at [65(6)] that Mr Harford was actually aware of the connection between Mr McMahon and Instant and between Mr Maguire and KWD. It also made findings, at [110] to [112] that we consider in the section below, that aspects of this connection would in any event have been revealed by an examination of records at Companies House.

18. Northside's suppliers in the disputed transactions had connections with multiple business addresses:

> (1) KWD had a registered principal place of business for VAT purposes ("PPOB") at 27a Castlegate in Roxburghshire in Scotland ([57(4)]), but a registered office for company law

purposes that changed over time, but between 16 November 2016 and 5 October 2017 was 31 Langley Park in London ([50(8)]).

(2) Instant had various PPOBs and registered offices but at the time of the disputed transactions its PPOB and registered offices coincided and were at 72 Bardsay Road and then 31 Langley Park ([50(4)], [56(9)] and [56(10)]).

(3) DLL's PPOB changed over time, but at the time of its supplies to Northside, it had a PPOB at 38 Market Square ([58(25)]) and a company law registered office at a different address. That said, invoices that DLL issued bore the 38 Market Square address, so there was no inconsistency between the PPOB and the address that DLL quoted on invoices ([111(1)]).

(4) Since Mohawk was a trading name of Mr Murdock who, being an individual, had no registered office for company law purposes. His PPOB was given as an address in Downpartrick Business Centre in Northern Ireland ([55]). However, invoices he issued quoted an address in Plymouth ([50(2)]).

19. Instant and KWD had no actual presence at an address they purported to use. As noted in paragraph 18 above, for a time, Instant's PPOB and its registered office for company law purposes were at 31 Langley Park. KWD's registered office for company law purposes was at 31 Langley Park. However, 31 Langley Park was a residential house in multiple occupation owned by the Henderson Christian Housing Association (the "HCHA") and none of the tenants was Instant, KWD or Mr Maguire, who had told Officer Gomez of HMRC that a meeting to discuss the VAT affairs of KWD could take place at the 31 Langley Park address ([50(11)]).

The FTT's evaluative findings as to means of knowledge

20. After explaining, at [104], why it concluded that Northside did not have actual knowledge of the fact that its transactions were connected with fraudulent evasion of VAT, the FTT turned to the question whether it had means of knowledge. The FTT found this to be a much more difficult question stating, at [106], that it was "bemused" by some of the arguments that HMRC had put forward in support of their case. At [108] and [109], the FTT commented that HMRC had "blindly applied" the various factors set out in PN 726 as indicating that Northside should have known that its transactions were connected with fraudulent evasion of VAT. The FTT considered that such an approach was not warranted since "… a factor which might well point to constructive knowledge of a connection with fraud in the case of a mobile telephone might not do so in the case of a used car". The FTT observed that it would have been more logical for HMRC to draw out the differences, if any, between those transactions from the four suppliers which could be traced back to fraud and Northside's other purchases of cars from other suppliers, but that HMRC had chosen not to do so. Moreover, the FTT found, at [110], that in fact the purchases of cars from the four suppliers which could be traced back to fraud "resembled in many ways" Northside's purchases from large company suppliers that were not connected with fraud.

21. At [110], the FTT set out a number of matters that "ought to have alerted the Appellant to the fact that those purchases were connected with VAT fraud". Northside argues that some of the FTT's language used in this paragraph demonstrates that it was applying the wrong legal test by considering whether Northside should have known that there was a risk its transactions were connected with fraud, rather than considering whether it had means of knowledge of an actual connection. We use a bold typeface to indicate phraseology which Northside criticises.

22. At [110(1)] to [110(7)], the FTT set out factors that should have led Mr Harford to visit the business premises of its suppliers. Those findings were in addition to a finding at [65(6)] that Officer Lowth of HMRC had expressly told Mr Harford that he should visit the premises of Northside's

suppliers as set out in invoices. The FTT found that as Northside was dealing with new businesses ([110(1)]) with no trading history (described in HMRC's PN 726 and booklet "How to spot missing trader fraud" as "**potential indicia of fraud**"), in consequence Northside should have taken up references for the four suppliers and conducted searches at Companies House and the VAT Information Exchange System ("VIES") ([110(2)]). Had it conducted those searches, Northside would have seen that there were potential discrepancies and issues calling for further investigation. In the case of Mr Murdock, he was issuing invoices in the name of "Mohawk Trading". An online search of Companies House records would have revealed the existence of a company called Mohawk Trading Company Limited which had no apparent connection with Mr Murdock, but had its registered office on the same road as the address Mr Murdock was using on his invoices. Having checked Companies House and VIES records, Mr Harford would have seen that there were differences between the PPOB and registered offices of KWD and DLL. These differences should have prompted him to visit the business premises of those companies.

23. At [110(8)], the FTT made a finding as to what would have happened if Mr Harford had tried to visit the business premises of Instant and KWD as follows:

> (8) the best example of how such a visit would have **aroused suspicion** is the fact that 31 Langley Park was occupied by the HCHA and that no-one at that address was aware of either Mr Maguire, Instant or KWD. That address was quite clearly not the place where either of Instant or KWD was carrying on business and Mr Harford should have ascertained that fact by visiting those premises, particularly given the prominence of 31 Langley Park in relation to both Instant and KWD. The same could be said for 72 Bardsay Road, which Mr Harford also did not visit.

24. At [110(9)], the FTT concluded that if Mr Harford had carried out "the appropriate due diligence", he would have discovered that Companies House records showed Mr McMahon, about whom HMRC had expressly warned, and whose company MCM was the subject of the tax loss letter, was a director of Instant at material times in 2017. The FTT commented:

> That would have served to alert him to the fact that the Appellant **should not purchase vehicles from Instant**.

25. At [110(10)], the FTT concluded that, if Mr Harford had carried out "the appropriate due diligence" he would have discovered that Companies House records showed that Mr Maguire, with whom Mr Harford was dealing at Instant, was also the 100% owner of KWD and a director of KWD. That, reasoned the FTT, showed a connection between KWD and Mr McMahon through Mr Maguire (since Mr Maguire was co-director with Mr McMahon at Instant and the sole director and shareholder in KWD) and:

> … would have alerted Mr Harford to the fact that the Appellant **should not purchase vehicles from KWD**.

26. At [110(12)], the FTT emphasised the links between Instant and KWD that would have been discovered from searches at Companies House and VIES to which we have already referred in paragraph 16 above. It also commented that:

> each of Instant and KWD was registered for VAT on the basis that its business involved "[business] consultancy services", as opposed to the sale of used cars, in itself a **ground for suspicion.**

27. At [110(13)], the FTT noted some points that were in Northside's failure, namely that a relative lack of written records did not mean either (i) that there had been no negotiations as to the price Northside would pay for vehicles bought in the disputed transactions or (ii) that the parties had no

interest in those vehicles. However, in a passage we will quote in full later in our decision since Northside subjects it to particular criticism, the FTT commented adversely on the absence of contemporaneous records concluding that:

> … the entire absence of any written record of those details, whether on the face of the invoices or by way of a communication between the parties or by way of an internal note serving as an aide memoire for Mr Harford, is noteworthy and **contributes to the overall impression that the transactions with these suppliers were inappropriate**.

28. At [111], the FTT noted that not all of the reasoning in [110] applied to purchases from DLL since there was no discrepancy between the address that it gave on its invoices and its PPOB, Mr McMahon had no links with DLL and DLL had no connection with the 72 Bardsay Road or 31 Langley Park addresses which Instant and KWD were said to use. However, the FTT placed weight on the fact that Mr Donnelly, with whom Mr Harford claimed he was dealing in relation to purchases from DLL, had no involvement with DLL in 2017. It concluded:

> …This calls into doubt the evidence of Mr Harford that his contact at DLL at the time of the purchases made by the Appellant from DLL was Mr Donnelly. It inevitably means either that Mr Harford's testimony cannot be accepted (and he dealt with someone other than Mr Donnelly in effecting those purchases without ascertaining the identity of, or doing any due diligence in relation to, that person) or that Mr Harford did deal with Mr Donnelly but Mr Donnelly had no authority to represent DLL at the relevant time and some rudimentary due diligence on the part of Mr Harford would have alerted him to that fact, or, at the very least, prompted some additional questions from Mr Harford as to Mr Donnelly's relationship with DLL.

29. At [113], the FTT set out its overall conclusion in the following terms:

> 113. We have found it difficult to reach a conclusion on the question of whether the Appellant should have known that its purchases from the relevant suppliers were connected with fraud. In considering that question, we have been cognisant of the very high bar laid down by the authorities cited above, to the effect that, after taking into account all of the relevant factors associated with the transactions, the connection with fraud must be the only reasonable explanation for the transactions and not simply one possible explanation. After weighing up the position in relation to each purchase from the relevant suppliers on the basis of applying the "no other reasonable explanation standard", we have concluded, on balance, that, for the reasons set out in paragraphs 110 to 112 above, the only reasonable explanation for each purchase was that it was connected with fraud. We think that the position is clearer in relation to the purchases from each of Mohawk, Instant and KWD than the purchases from DLL, for the reasons set out in paragraph 111, but we have concluded that, even in the case of DLL, there are sufficient grounds in paragraphs 110(1), 110(2), 110(13) and 112 to conclude that the only reasonable explanation was the connection with fraud.

Northside's grounds of appeal against the Decision

30. There was some disagreement between the parties as to the scope of Northside's grounds of appeal.

31. Northside applied to the FTT for permission to appeal on 31 August 2021. That application was settled by Mr Watkinson of counsel who appeared for Northside at the hearing before us. A single ground of appeal was listed, summarised as "The FTT misapplied the 'only reasonable explanation' test". In its decision on the application, the FTT stated simply that it granted permission to appeal and did not set out, in its own words, the grounds on which it was granting permission.

32. In his written and oral submissions, Mr Watkinson developed his grounds of appeal by making the following four broad submissions. HMRC accept that all these submissions fall within the scope of the permission granted by the FTT.

> (1) Submission 1 – The language that the FTT used at [110] to [113], with its repeated references to the risk of a connection with fraud which we have set out in bold in the section above demonstrated that the FTT was applying the wrong legal test when it assessed whether Northside "should have known" that the disputed transactions were connected with VAT fraud.
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> (2) Submission 2 – The FTT's process of reasoning set out at [110] to [113] demonstrates that the FTT was impermissibly focusing narrowly on the extent of Northside's due diligence. It failed to stand back and weigh up all the inferences that could be drawn from the circumstances of the transactions as a whole and so ignored the plethora of factors suggesting that the disputed transactions were, viewed objectively, commercially normal transactions rather than only being explicable by a connection with VAT fraud.
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> (3) Submission 3 – The FTT's reference to a lack of written records of specifications at [110(13)] makes no logical sense in the context of the "should have known" test and demonstrates that the FTT was diverted from the practical application of the "only reasonable explanation" test by this consideration.
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> (4) Submission 4 - The FTT's overall conclusion on "should have known" could not be supported by its findings of primary fact.

33. The parties were agreed that an appeal to this Tribunal can be brought only on a point of law. Thus, they were agreed that this Tribunal has no power to set aside the FTT's findings of fact even if we disagree with the FTT's findings or consider it likely that we would have made different findings if we had been sitting at first instance. They were also agreed that we had power to interfere with the Decision if we identified fundamental flaws in the fact-finding process (as distinct from a disagreement with the actual findings of fact) for example if the FTT took into account irrelevant considerations or failed to take into account relevant considerations. It was also common ground that we have power to interfere with the Decision if the FTT's overall conclusion on means of knowledge was one that "no person acting judicially and properly instructed as to the relevant law could have come to" (or, as a shorthand, that it was "perverse") because in those circumstances we would be bound to assume that there has been some misconception of the law and that this has been responsible for the determination (*Edwards v Bairstow* [1956] AC 14 per the speech of Lord Radcliffe at page 36).

34. At the margins, questions of some difficulty can arise as to whether the selection of which considerations are relevant, and which irrelevant, involves a question of fact or law. We tend to agree with Mr Watkinson's submission, based on the judgment of Arden LJ, as she then was, in *Davis v Dann Ltd v HMRC* [2016] EWCA Civ 1899 at [101] that the categorisation of matters as relevant or irrelevant involves a question of law, but that a superior court or tribunal should only interfere with the categorisation adopted by the fact-finding tribunal if that categorisation was perverse in the sense that it could not have been adopted by any reasonable tribunal. However, as will be seen from the next paragraph, we do not need to determine any question of categorisation in this case.

35. Nevertheless, there remained some disagreement between the parties as to what Northside needed to show in order to succeed with its Submissions 1 to 4 which we have resolved as follows:

(1) Submission 1 does not require Northside to establish that any aspect of the Decision is perverse. This submission is a challenge on a pure point of law, namely that the FTT applied the wrong test when reaching its conclusions.

(2) Given the way in which the parties have put their cases in relation to Submissions 2 or 3, neither of those submissions requires Northside to establish that an aspect of the Decision was perverse. Submission 2 will be determined by establishing whether or not the FTT took the factors referred to into account (since the parties are agreed that those factors are relevant). Submission 3 can be determined by establishing whether, and if so to what extent, paragraph [110(13)] were relevant and affected the FTT's conclusion. HMRC do not seek to argue that, even if the matters set out in that paragraph were legally irrelevant, the Decision is immune from challenge because it was reasonable for the FTT to conclude that those matters were relevant.

(3) Submission 4 involves a straightforward assertion of perversity of the kind described in the extract from *Edwards v Bairstow* set out in paragraph 33 above.

Discussion

Submission 1

36. We are grateful to Mr Watkinson for, in accordance with his duties to the court, drawing to our attention the judgment of the Court of Appeal in *DPP Law Ltd v Greenberg* [2021] EWCA Civ 672 ("*DPP Law*"). In that case, Popplewell LJ said, at [58]:

> Moreover, where a tribunal has correctly stated the legal principles to be applied, an appellate tribunal or court should, in my view, be slow to conclude that it has not applied those principles, and should generally do so only where it is clear from the language used that a different principle has been applied to the facts found. Tribunals sometimes make errors, having stated the principles correctly but slipping up in their application, as the case law demonstrates; but if the correct principles were in the tribunal's mind, as demonstrated by their being identified in the express terms of the decision, the tribunal can be expected to have been seeking faithfully to apply them, and to have done so unless the contrary is clear from the language of its decision. This presumption ought to be all the stronger where, as in the present case, the decision is by an experienced specialist tribunal applying very familiar principles whose application forms a significant part of its day-to-day judicial workload.

37. The parties are agreed that the FTT correctly stated the legal principles. Therefore, there is a presumption it applied those principles correctly. Northside seeks to displace that presumption by focusing on the FTT's references, in paragraphs [110] to [113] which we have emboldened in paragraphs 22 to 28 above, to potential risks. It argues that these references indicate that the FTT impermissibly proceeded on the basis that means of knowledge of a <u>risk</u> of connection with fraud was sufficient to satisfy the "only reasonable explanation" test.

38. In our judgment, Northside's focus on occasional words or phrases in paragraphs [110] to [113] fails to put those words and phrases in their proper context. The FTT was quite entitled to proceed on the basis that, in a case such as this, there would be no single "killer" fact or circumstance that would have demonstrated to a reasonable trader that the disputed transactions were connected with fraud. It was permissible for the FTT to proceed on the basis that means of knowledge of an <u>actual</u> connection with fraud could exist if Northside had means of knowledge of a cumulation of factors or circumstances, each of which on their own pointed to a risk provided that, <u>taken together</u>, those factors would have demonstrated to a reasonable trader that the disputed transactions <u>actually were</u> connected with fraud.

39. That is the process of reasoning that the FTT was following in [110] to [113]. Once that is appreciated, we see no error of law in the FTT's use of the phrasing that Northside criticises. Thus:

> (1) Northside criticises the FTT's reference, at [110(1)] to the fact that the suppliers were new businesses was described in PN 726 as "potential indicia of fraud". It is difficult to see how the FTT could have expressed this paragraph differently without either misquoting PN 726 or engaging in exaggeration. The recent formation of the businesses could not fairly be described as conclusive of a connection to fraud, and PN 726 could not fairly make such a claim. The FTT was doing nothing more than listing a factor that had the capacity, when put to together with other factors, to demonstrate a connection with fraud.
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> (2) The same analysis applies to the statement at [110(8)] that a visit to 31 Langley Park would have "aroused suspicion". The fact that averred business premises used by Instant and KWD were residential premises owned by a charity that had not heard of either company was plainly a relevant factor. The FTT did not have to say that it was conclusive on its own for it to be relevant to Northside's means of knowledge. The same analysis applies to the reference to "arousing suspicion" in [110(12)].
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> (3) Read in context the reason the FTT concluded in [110(9)] and [110(10)] that Northside "should not purchase vehicles" from KWD and Instant was because of those companies' links to Mr McMahon. The FTT was entitled to regard that as an indicator of connection with fraud. It did not have to be conclusive on its own.
>
> (4) We will deal with the paragraph after [110(13)] in our analysis of Submission 3.

40. We are only fortified in our conclusion by the fact that the FTT said expressly at [113] that it was quite aware that connection with fraud must be the "only reasonable explanation for the transactions and not simply one possible explanation". Northside submitted that the FTT was bound to express its conclusion in those terms given the self-direction as to the law that it had made, and that [113] could not therefore save the Decision from the errors that were already manifest in paragraphs [110] to [112]. We reject that submission. In our judgment, [113] makes it clear that the FTT was following a permissible approach by ascertaining means of knowledge of actual connection to fraud from an amalgamation of individual risks.

41. We reject Northside's Submission 1.

Submission 2

42. Northside's Submission 2 is premised on the proposition that the FTT ignored a host of highly relevant factors in coming to its conclusion. Those factors were set out in Mr Watkinson's written skeleton argument as follows:

> there was a commercial rationale for the transactions as evidenced by NFL having the same business model for the antecedent 4 ½ years; the vehicles existed; there was strong evidence that the transactions were preceded by ordinary negotiations; the vehicles were traded at market price and within a normal range of profits (i.e. the transactions were not "too good to be true"); there was nothing odd about the volume of transactions, the turnover they produced or the resultant input tax reclaims; there was nothing odd about either the transaction documentation itself or the terms of the transactions; there was nothing odd about the insurance position; there was nothing odd about the transportation of the vehicles; and there was no difference pointed to by the Respondents between how the impugned transactions were carried out and how those undertaken by NFL that were not connected with any VAT fraud were carried out.

43. Submission 2 has an unpromising start because Northside accepts that the FTT mentioned all of these factors in the Decision. We stress that we are far from saying that the only way a factor can be shown to be taken into account is if that factor is expressly mentioned in the Decision. As Popplewell LJ said at [67] of *DPP Law* to which we have already referred: "it is ... false reasoning that what is out of sight in the language of a decision must be assumed to be non-existent or out of mind". However, in our judgment, the express reference to the factors on the face of the Decision is a strong indicator that the factors were taken into account.

44. Northside's complaint, therefore, relies on the fact that the FTT did not expressly cross refer to all of these factors when it set out the balancing exercise described between [110] and [113]. We reject that complaint. As Ms Vicary pointed out in her oral submissions, it amounts to a criticism of the FTT's failure to repeat itself in what was already a lengthy decision. It is clear on the face of the decision that the FTT had well in mind that there were aspects of the transactions and the circumstances in which they were undertaken that pointed away from a conclusion that Northside had means of knowledge of connection to fraud. It referred to a subset of those factors expressly when introducing its balancing exercise at [110] by referring to "the fact that [the disputed transactions] resembled in many ways the purchases that the Appellant made from its large company suppliers". The FTT's repeated reference to the difficulty it had in deciding the case demonstrates that it had the relevant factors firmly in mind since it was those factors that were the cause of the difficulty.

45. The factors to which Northside refers were all taken into account and balanced and we reject Submission 2.

Submission 3

46. Submission 3 focuses on the passage that appears after [110(13)] in which the FTT accepted that the disputed transactions could well not have taken place at fixed places and could have been preceded by negotiations. The passage at issue reads as follows:

> However, we do think that it is noteworthy that the Appellant has not provided the Respondents with a single written record, whether in the form of an email, text or handwritten piece of paper, which described the specifications of the vehicles purchased and their condition at the time of purchase. Even if the negotiations preceding each purchase were conducted by telephone, one would have expected to see some sort of written record of these details prepared by Mr Harford for his own benefit, not least because Mr Harford was not dealing with established companies with proven track records but was instead dealing with people who were new to him. We would hesitate to draw from this the conclusion that the specifications and condition of the vehicles were of no moment to the Appellant but the entire absence of any written record of those details, whether on the face of the invoices or by way of a communication between the parties or by way of an internal note serving as an aide memoire for Mr Harford, is noteworthy and contributes to the overall impression that the transactions with these suppliers were inappropriate.

47. We agree with Northside that this passage is somewhat confusing. It appears in the FTT's analysis of Northside's (objective) means of knowledge at a point in the Decision by which the FTT had already found that Northside did not have (subjective) actual knowledge of a connection with fraud. It is not clear what bearing Northside's own failure to keep full records has on the question of whether a reasonable trader, having deployed available means of knowledge, would have known that the disputed transactions were connected with fraud.

48. However, the fact that the paragraph is confusing does not of itself mean that it betrays an error of law. The FTT's conclusions and reasoning must be determined from an analysis of the Decision

as a whole. As Mummery LJ said at p813 of the judgment of the Court of Appeal in *Brent v Fuller* [2011] ICR 806:

> The reading of an employment tribunal decision must not, however, be so fussy that it produces pernickety critiques. Over-analysis of the reasoning process; being hypercritical of the way in which a decision is written; focussing too much on particular passages or turns of phrase to the neglect of the decision read in the round: those are all appellate weaknesses to avoid.

49. In our judgment, the paragraph after [110(13)] is unnecessary and the reference to the "overall impression" that the transactions were "inappropriate" is unfortunate and lacks precision. However, when the Decision is read as a whole in the light of the FTT's self-direction as to the law which both parties agree to be correct, it is clear that the FTT realised that the "should have known" aspect of the *Kittel* test involved an objective examination. Moreover, it is clear that the FTT realised that Northside's entitlement or otherwise to input tax depended not on the FTT's "overall impression" of whether the transactions could be described as "inappropriate", but on whether Northside should have known that the disputed transactions were connected with fraud. As we have concluded when addressing Northside's Submission 1, read as a whole, that was the test that the FTT applied in the Decision.

50. Therefore, unclear though it was, the paragraph after [110(13)] is just a single paragraph in a lengthy judgment that elsewhere is both clear and accurate as to the test that needs to be applied. We do not accept Northside's submission that this single paragraph demonstrates that the FTT was diverted from an application of the correct test and we reject Submission 3.

Submission 4

51. In her written skeleton argument on behalf of HMRC, Ms Vicary drew our attention to a number of authorities that explained the reluctance of appellate courts to interfere with factual findings of the first instance court or tribunal and the reasons for that reluctance. We need not refer to all of those authorities. A flavour of this element of Ms Vicary's submissions can be seen from the well-known statement of Briggs J (as he then was) in *Georgiou v Customs & Excise Commissioners* [1996] STC 463 at [476] to the effect that appellants seeking to overturn factual findings should not assume that they have permission to advance a "roving selection of the evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong".

52. That is, of course, a correct statement of the law. However, we did not consider that, in its Submission 4, Northside was putting forward a "roving selection of the evidence" of the kind that Briggs J had in mind. Its argument is more focused. It submits simply that, even taking into account all of the findings of primary fact that the FTT made, and without seeking to challenge any of those findings, no reasonable tribunal could have concluded that Northside "should have known" that the disputed transactions were connected with fraudulent evasion of VAT.

53. Nevertheless, Northside has a high hurdle to overcome to succeed with Submission 4. It is not enough to establish that the FTT could permissibly have come to a different conclusion. It would not even be enough for Northside to persuade us that we ourselves would have come to a different conclusion since, as Ms Vicary pertinently and concisely observed, the Upper Tribunal is not a "court of second opinion" on factual matters. Rather, Northside must establish that no reasonable tribunal, having made the findings of primary fact that it did could have concluded that Northside "should have known" that its transactions were connected with fraud.

54. We have no hesitation in rejecting that argument as applicable to the purchases that Northside made from Instant and KWD. The FTT found that a reasonable trader would have performed some

due diligence on Instant and KWD that involved searching records at Companies House and visiting their business premises including 31 Langley Park. That finding is not challenged. If Northside had visited 31 Langley Park, it would have discovered that it was a residential building no part of which was let to Instant or KWD and whose owners had not heard of those companies. If Northside had searched Companies House records, it would have seen that Instant had a connection with Mr McMahon who was also involved with MCM, the company mentioned in the tax loss letter. It would have seen that there was some link between Instant and KWD through Mr Maguire and so KWD also had a connection of some kind with Mr McMahon. Indeed, the FTT found at [65(9)(a)] that Mr Harford was actually aware of these links. The analysis in the Decision shows that Northside sought to persuade the FTT that these factors were insufficient to demonstrate that it "should have known" that purchases from Instant and KWD were connected with fraud and it emphasised other factors pointing against that conclusion. However, it cannot be said that, in declining to be persuaded, and in drawing the evaluative conclusion that Northside should have known that purchases from Instant and KWD were connected with fraud, the FTT made a decision so perverse that no reasonable tribunal could have reached it.

55. In his oral submissions, Mr Watkinson made a forceful criticism of the FTT's decision as regards purchases from DLL. He noted that, at [113], the FTT based its conclusion as regards DLL on paragraphs [110(1)], [110(2)], [110(13)] and [112]. However, he submitted, those paragraphs could not support the conclusion because:

> (1) Paragraph [110(1)] referred to Northside's suppliers being "incorporated very recently" and having "no trading history". Neither statement was true of DLL. It had been incorporated on 27 October 2015, which could not be described as "very recently" in the context of its transactions with Northside that took place in June and July 2017. It had submitted two VAT returns since incorporation and so must have had a "trading history".
>
> (2) Paragraph [110(2)] referred also to the recent incorporation and non-existent trading history, neither of which applied to DLL.
>
> (3) Paragraph [110(13)] was a point in Northside's favour as it suggested that there were proper negotiations as to price when Northside purchased vehicles. The paragraph that followed, although not part of [110(13)] contained the flawed reference to an absence of business records.
>
> (4) Paragraph [112] was equivocal. It made no finding as to whether or not Mr Harford did deal with Mr Donnelly or the significance of the absence of Mr Donnelly's authority to represent DLL.

56. The question whether DLL's incorporation was "very recent" was evaluative. It needed to be considered in the light of all the evidence including as to Northside's conduct of its business and practice in the second-hand car business. It was not perverse for the FTT to describe DLL as incorporated "very recently". The FTT was mistaken to say that DLL had "no trading history", but its trading history was clearly limited and we do not consider that the FTT's point would have been materially different if it had referred to a "limited" trading history. We have dealt with the criticisms of [110(13)] in dealing with Issue 3.

57. It is important not to lose sight of the FTT's overall finding when considering the detail of Northside's criticism as the extract from Mummery LJ's judgment in *Brent v Fuller* set out in paragraph 48 above makes clear. Northside was dealing with a new business. It failed to perform "rudimentary" due diligence on that business. DLL itself defaulted fraudulently on its VAT obligation, so this was not a case where the default was several links down a lengthy chain of suppliers. Of course, Northside does not lose entitlement to input tax credit simply as a penalty for

what might be termed a negligent failure to make reasonable checks since the overall question is whether it should have known that its purchases from DLL were connected with fraud. However, there is nothing inherently surprising about the conclusion that a trader that fails to perform rudimentary due diligence on a supplier which turns out to default fraudulently on its VAT obligations would have discovered the connection with fraud perpetrated by that very trader had it made rudimentary checks. That is not to say that the conclusion will follow in every case. It remains necessary to consider what information would have been gleaned if those checks had been performed. However, the overall plausibility of the FTT's conclusion serves as a warning that we should not lightly find it to be perverse.

58. Northside criticises what it submits was the FTT's "narrow focus" on due diligence and "over-compartmentalisation" of its analysis. We reject that criticism. As we have noted in our conclusion on Submission 2, the FTT properly considered inferences that were in Northside's favour. In asking itself what information Northside would have discovered if it had made rudimentary checks, the FTT was not focusing narrowly on due diligence, but was following a reasonable line of enquiry as to its means of knowledge.

59. The FTT found that a reasonable trader would have checked Companies House records and those records would have revealed that Mr Donnelly had no authority to represent DLL. Those findings are not challenged. The FTT was entitled to conclude that two possibilities emerged:

> (1) Mr Harford was dealing with Mr Donnelly, who was purporting to act on behalf of DLL, but a reasonable trader would have realised that Mr Donnelly had no authority to represent DLL at all.
>
> (2) Mr Harford was dealing with someone other than Mr Donnelly despite the fact that he had told both HMRC and the FTT that he was dealing with Mr Donnelly.

60. The FTT was entitled to conclude that either possibility had implications for Northside's means of knowledge. The situation described in paragraph 59(1) would have been a clear indicator of fraud. The situation described in paragraph 59(2) would have suggested that Mr Harford had some reasons for wishing to mislead HMRC and the FTT and a reasonable trader, aware of those reasons, would have concluded that the transactions with DLL were connected with fraud. It was for the FTT to evaluate the significance or otherwise of the situation with Mr Donnelly as part of its overall multifactorial evaluation.

61. Therefore, although we considered that there was force to Northside's criticisms of the FTT's conclusion in relation to DLL, we have concluded that those criticisms are insufficient to demonstrate that the FTT's conclusion was perverse, which is a high hurdle.

62. Northside did not challenge the FTT's conclusion in relation to Mohawk in the same level of detail as it did with DLL, although it does submit that the conclusion was not available to the FTT. We reject that argument for reasons that are similar to those set out above.

63. The analysis set out in paragraph 57 applies to Mohawk, just as much as to DLL. It was a matter for the FTT to evaluate the significance of indicators of a connection with fraud when weighed against the contra-indications that we have discussed in our analysis of Northside's Submission 2. The FTT concluded that it was significant that Mr Murdock, while supplying vehicles for delivery in Ireland, and having a PPOB in Northern Ireland, was providing invoices giving a trading address in Plymouth. We are not sure that we would have concluded, as the FTT did, that a reasonable person dealing with a sole trader like Mr Murdock would have considered it necessary to perform searches against the name "Mohawk" at Companies House since Mr Murdock was not, and was not purporting to operate

through, a limited company. However, it was for the FTT to decide what checks a reasonable trader would have undertaken and its evaluative conclusion was available to it. The FTT was entitled to conclude that there was something odd about the fact that the address Mr Murdock gave in Plymouth was very close to the registered office of an ostensibly unrelated company containing the word "Mohawk" in its name. It raised the possibility that Mr Murdock was adopting the trading style of an unconnected enterprise for fraudulent purposes. Different tribunals might have reached different conclusions on the strength of this indication and on the question whether, looking at the totality of relevant facts and circumstances, a reasonable trader would have been aware of the connection with fraud. However, we are not satisfied that the FTT's overall conclusion was perverse.

64. We therefore dismiss Northside's arguments under Submission 4.

Disposition

65. Northside's appeal is dismissed.

Signed on Original

JUDGE JONATHAN RICHARDS

JUDGE NICHOLAS ALEKSANDER

RELEASE DATE: 22 September 2022