TC 01672

Appeal number: LON/2006/0789 and LON/2006/0790

VALUE ADDED TAX – input tax – denial of right to deduct on grounds that the Appellants knew or should have known that the transactions were connected to the fraudulent evasion of VAT – whether Appellant "knew or should have known" of connection to fraud – yes – valid refusal of right to deduct – appeal dismissed

FIRST-TIER TRIBUNAL

TAX

CROTEK LIMITED **Appellants**
CROTEK SYSTEMS LIMITED

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
ELIZBETH BRIDGE (MEMBER)

Sitting in public at 45 Bedford Square, London WC1 on 4, 5, 6, 9, 10, 12, 13, 16, 17, 18, 19 May 2011

Ariyeh Kramer, Solicitor, Warner Pollins, for the Appellants

Michael Parroy QC, Jennifer Goldring and James Bewley, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. Crotek Limited (“CL”) and Crotek Systems Limited ("CSL") (collectively "the Appellants") appeal against five decision letters of the Respondents ("HMRC") denying the Appellants the right to deduct input tax totalling £5,690,347.25 in respect of 34 transactions concerning the purchase of mobile telephones between February 2006 and May 2006.

2. Of those five decision letters, two relate to CL and concern six transactions. The remaining three decision letters relate to CSL and concern 28 transactions. In addition, input tax was denied in respect of nine transactions by a decision letter dated 29 August 2006 and the decision in respect of those nine transactions has not been appealed.

3. There are, therefore, 34 transactions which form the subject matter of this appeal. The total amount of input tax denied in respect of those 34 transactions is £5,690,347.25.

4. HMRC denied the Appellants' right to deduct input tax on the basis that the Appellants' transactions were connected to the fraudulent evasion of Value Added Tax ("VAT") and that each Appellant knew or should have known that its transactions were connected to such fraudulent evasion.

The decisions under appeal

The first Appellant

5. The first decision in relation to CL is contained in a letter from HMRC dated 13 July 2006. This letter informed CL that input tax totalling £605,010 in respect of three transactions falling within the VAT period 04/06 had been denied.

6. The second decision letter, dated 29 August 2006, notified CL that its claim to deduct input tax in respect of three transactions falling within the VAT period 04/06 in the amount of £396,760 had been denied.

The second Appellant

7. As noted above four decision letters related to CSL. The first decision letter was dated 13 July 2006 and notified CSL that input tax totalling £1,687,542.50 had been denied in respect of 10 transactions falling within VAT periods 02/06, 03/06 and 04/06.

8. The second decision letter was dated 28 July 2006 and notified CSL that input tax, totalling £1,738,415, in respect of a further 10 transactions falling within the VAT periods 02/06 and 03/06 had been denied.

9. The third decision letter was dated 4 August 2006 and notified CSL that input tax, totalling £239,120, in respect of one transaction falling within the VAT period 02/06 had been denied.

10. The fourth decision letter was dated 8 March 2007 and notified CSL that input tax, totalling £1,023,499.75, in respect of seven transactions falling within the VAT period 05/06 had been denied.

11. As noted above, another decision letter dated 29 August 2006 was not appealed. This decision letter notified CSL that input tax, totalling £1,843,087.75, in respect of nine transactions falling within the VAT period 04/06 had been denied. The evidence put forward by HMRC included these nine transactions as part of the factual background to the 34 transactions under appeal.

12. The Appellants appealed against all the decision letters (except that contained in the letter dated 29 August 2006) referred to above.

MTIC Transactions – Background

13. HMRC contend that all the transactions entered into by the Appellants, on which they based their claims to deduct input tax, form part of what is described as "Missing Trader Intra-Community" ("MTIC") fraud. The "classic way" in which the fraud works was described by Christopher Clarke J in *Red 12 Trading Ltd v HMRC* [2009] EWCH 2563 as follows (at paragraph 2):

> "2….Trader A imports goods, commonly computer chips and mobile telephones, into the United Kingdom from the European Union ("EU"). Such an importation does not require the importer to pay any VAT on the goods. A then sells the goods to B, charging VAT on the transaction. B pays the VAT to A, for which A is bound to account to HMRC. There are then a series of sales from B to C to E (or more). These sales are accounted for in the ordinary way. Thus C will pay B an amount which includes VAT. B will account to HMRC for the VAT it has received from C, but will claim to deduct (as an input tax) the output tax that A has charged to B. The same will happen, mutatis mutandis, as between C and D. The company at the end of the chain – E – will then export the goods to a purchaser in the EU. Exports are zero-rated for tax purposes, so trader E will receive no VAT. He will have paid input tax but because the goods have been exported he is entitled to claim it back from HMRC. The chains in question may be quite long. The deals giving rise to them may be effected within a single day. Often none of the traders themselves take delivery of the goods which are held by freight forwarders."
>
> "5. A jargon has developed to describe the participants in the fraud. The importer is known as "the defaulter". The intermediate traders between the defaulter and the exporter are known as "buffers" because they serve to hide the link between the importer and the exporter, and are often numbered "buffer 1, buffer 2 etc. The company which exports the goods is known as "the broker".

14. For simplicity, but without thereby prejudging the issue, we shall adopt the same terminology of "defaulter (s)" (sometimes also known as "missing traders"), "buffers" and "brokers". References to HMRC in this decision also include its predecessor, HM Customs and Excise.

15. Some MTIC appeals involve a variation on the typical transaction, described above by Christopher Clarke J, known as contra-trading. These appeals, however, do not involve contra-trading.

Issues in dispute

16. During the hearing of this appeal, Mr Kramer, representing the Appellants, accepted that the Appellants' transactions were all connected with the fraudulent evasion of VAT. He also accepted that HMRC had sustained a tax loss in the transaction chains of which the Appellants' transactions formed part.

17. The issue in dispute, therefore, was whether the Appellants, through their "controlling minds", knew or should have known that their transactions were connected with the fraudulent evasion of VAT. It was accepted that Mr Safdar Dad ("Mr Dad") was the controlling mind of each Appellant for these purposes.

The evidence

Documentary evidence

18. We were provided with 41 files of witness statements and supporting exhibits.

Witness evidence

19. Witness statements from the following witnesses were admitted as evidence. These witnesses did not give oral evidence and their witness statements were accepted and were not challenged by the Appellants. The witnesses were:

(1) Andrew Paul Monk – an HMRC officer allocated responsibility for the defaulting trader XS Enterprise Systems Limited ("XS Enterprises").

(2) Terrence Mendes – an HMRC officer allocated responsibility for the defaulting traders FX Drona Limited ("FX Drona") and Ultimate Security Agency Limited ("Ultimate"). Mr Mendes submitted separate witness statements for each defaulting trader.

(3) Sheila Edmead -an HMRC officer allocated responsibility for the defaulting trader Stella Communications UK Limited ("Stella").

(4) Peter Allen Cameron-Watson – an HMRC officer allocated responsibility for the defaulting trader Oracle (UK) Limited ("Oracle").

(5) Damien Mario Parsons – an HMRC officer allocated responsibility for the defaulting trader Puwar Business Co-Operation (UK) Limited ("Puwar").

(6) Claire Sharkey – an HMRC officer allocated responsibility for a trader called Adworksuk.com Limited ("Adworks").

(7) Mathew Charles Bycroft – an HMRC officer allocated responsibility for the defaulting trader Midwest Communications Limited ("Midwest").

(8) Robert James David Lamb – an HMRC officer allocated responsibility for the defaulting trader Roble Comm Limited ("Roble").

(9) James Smallbone – an HMRC officer allocated responsibility for the defaulting trader Red Rose Consultancy Limited ("Red Rose").

(10) Gordon Murray Fyffe – an HMRC officer allocated responsibility for the defaulting trader Bullfinch Systems Limited ("Bullfinch").

(11) Kyle Angus Martyn – an HMRC officer allocated responsibility for Goldex International Plc ("Goldex").

20. The following witnesses were called by HMRC. They produced witness statements which were admitted to evidence and gave oral evidence. The witnesses were as follows:

(1) Nigel Saunders – an HMRC officer allocated responsibility for the Appellants. Mr Saunders produced three witness statements. The third witness statement related to evidence obtained from the Paris server of the First Curacao International Bank ("FCIB"). The admission of the evidence contained in the third witness statement and its supporting exhibits was disputed by the Appellants. For reasons given later in this decision, we decided to admit the evidence.

(2) Roderick Guy Stone – a senior HMRC officer who gave background evidence in relation to MTIC fraud.

(3) Susan Elizabeth Hirons – an HMRC officer allocated responsibility for the defaulting trader Zoom Products Limited ("Zoom").

(4) Alan John Ruler – an HMRC officer who gave evidence in relation to the trader Urban Spice Buyer Limited ("Urban ").

(5) David Young – an HMRC officer who gave evidence in relation to data derived from the FCIB Paris server. As with the third witness statement of Mr Saunders, the same dispute arose as to whether this evidence should be admitted. For the reasons given later in this decision, we decided to admit the evidence.

(6) John Fletcher – a Director in KPMG LLP ("KPMG") who gave expert evidence in relation to the grey market in mobile telephone handset distribution in 2006.

21. The Appellants called Mr Dad to give evidence. Mr Dad was a director of both Appellants. Mr Dad produced two witness statements, which were admitted into evidence, and gave oral evidence.

Credibility of witness evidence

22. We wish to make some initial comments about the credibility of the witnesses who gave evidence before us.

23. We considered the witnesses called by HMRC to be credible witnesses.

24. In relation to the evidence given by Mr Ruler concerning Urban, this evidence was mainly hearsay evidence. We express our reservations as regards the weight to be placed on this evidence later in this decision. However, in expressing those reservations we make no criticism of Mr Ruler's credibility. On the contrary, in our view, Mr Ruler was a credible and truthful witness.

25. In our view, Mr Dad was not a credible witness. As explained below, Mr Dad was frequently evasive in cross-examination and often failed to give direct answers to questions which were asked of him or gave answers were simply not credible. There was no doubt in our minds that important parts of Mr Dad's evidence were untruthful, as we explain more fully below. We therefore treated Mr Dad's evidence with considerable circumspection.

Applications to admit and exclude evidence

26. In the course of this hearing there were two applications by the Appellants to exclude evidence put forward by HMRC (the evidence of Mr Fletcher and Mr Stone). In addition, there was one application to admit new evidence made by HMRC in respect of the FCIB evidence of Mr Saunders and Mr Young derived from the "Paris server"

27. A Directions hearing in relation to these appeals was held on 11 April 2011 (before Judge Brannan) in order to deal with any preliminary issues between the parties prior to the substantive hearing of the appeals and because of uncertainty concerning legal representation of the Appellants. Objections to the admission of evidence should have been made at the Directions hearing. The Appellants did not appear and were not represented at the hearing. As far as we are aware, no explanation was given for their failure to attend. HMRC attended the hearing. HMRC stood over their application to admit the new FCIB evidence of Mr Saunders and Mr Young derived from the "Paris server" until the substantive hearing because the Appellants had failed to appear.

28. One of the main purposes of an interlocutory hearing is, inter alia, to avoid appeal timetables being disrupted by the making of applications that could conveniently have been dealt with at an interlocutory stage. Whilst the admission or exclusion of evidence is subject to the basic overriding principle in the Tribunal Rules that matters must be dealt with fairly and justly, the failure of a party to attend interlocutory proceedings without good reason is a matter that can be weighed in the overall balance by the Tribunal in the application of that overriding principle.

The transactions

29. The 34 transactions and (associated deal chains) which form the subject matter of these appeals and the nine un-appealed transactions covered by the decision letter of 29 August 2006 are set out in Appendix 1 to this decision. This information was derived from the witness evidence admitted on behalf of HMRC and was not in dispute between the parties.

The law

30. There was no dispute between the parties regarding the applicable legal principles, which we set out below. We have applied these principles in reaching our decision.

31. The legal right to a deduction for input tax is enshrined in Articles 167 and 168 of Council Directive 2006/112/EC of 28 November 2006 and in sections 24, 25 and 26 of the Value Added Tax Act 1994.

32. There is no legal right to a deduction for input tax, however, where fraud is involved. There is now extensive case law on the subject both before the European Court of Justice and our domestic courts. The position was conveniently summarised by Lewison J in the recent decision of the Upper Tribunal in *Brayfal Ltd v HMRC* [2011] UKUT B6 (TCC) as follows:

> "While Brayfal's appeal has been making its way through the system, the law has been considered by the courts on a number of occasions. It finds its latest authoritative pronouncement in the decision of the Court of Appeal in *Mobilx Ltd v HMRC* [2010] EWCA Civ 517. This decision was handed down on 12 May 2010, a couple of months after the revised decision of the FTT. That case examined the ramifications of the decision of the ECJ in *Axel Kittel v Belgium*; *Belgium v Recolta Recycling* Joined Cases C-439/04 and C-440/04 [2006] ECR 1-6161 ("*Kittel*"). What the Court of Appeal decided was:
>
> A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and fails to meet the objective criteria which determine the scope of the right to deduct. (§ 43)
>
> If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. (§ 52)
>
> The principle 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. (§ 60)
>
> The test 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. (§ 59)

> If HMRC wishes to assert that a trader's state of knowledge was such that his purchase is outwith the scope of the right to deduct it must prove that assertion. (§ 81)
>
> In answering the factual question, Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focusing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in *Kittel*, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was. (§ 82)
>
> I should also record that it was common ground that these principles should be applied in the light of the circumstances prevailing at the date of the taxable person's own transactions: C-354/03 *Optigen Ltd v Customs and Excise Commissioners* [2006] ECR I-483. "

33. We respectfully adopt Lewison J's summary of the law as a correct statement of the current position. Both parties accepted that this Tribunal was bound by the Court of Appeal's decision in *Mobilx.*

34. We would also draw attention to the comments of Moses LJ in *Mobilx* in relation to questions of evidence, where he said (at page 1459):

> The questions posed in *BSG* …by the tribunal were important questions which may often need to be asked in relation to the issue of the trader's state of knowledge. I can do no better than repeat the words of Christopher Clarke J in *Red 12 Trading Ltd v Revenue and Customs Comrs* [2009] EWHC 2563 (Ch) at [109]–[111], [2010] STC 589 at [109]–[111]:
>
> '[109] *Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.'*
>
> *[110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the*

> *fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.*
>
> *[111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them.'"*

35. It is worth adding that the standard of proof is the normal civil standard of proof i.e. the balance of probabilities.

The Appellants: background

Crotek Systems Limited

36. CSL was incorporated as a limited company in August 2004. The company's registered address was in High Wycombe, Buckinghamshire.

37. In the periods relevant to these appeals, CSL had one director: Mr Safdar Dad. The company secretary was Frieda Dad, the wife of Mr Dad's brother Mr Shafqat Dad. Mr Shafqat Dad had previously been a director of CSL but resigned on 24 August 2005. He had also been a company secretary of CSL but resigned when his wife took over the position on 17 June 2005.

38. Mr Dad stated that he purchased CSL from his brother. Nonetheless, his brother continued to hold the one share in CSL until on or around 29 August 2006, according to the annual return declaration signed by Mr Dad. However, a company report on CSL dated 11 January 2007 stated that Frieda Dad owned 50 £1 ordinary shares, a further 49 £1 ordinary shares were owned by Mr Safdar Dad and that Shafqat Dad owned 1 £1 ordinary share. Mr Dad stated that this constituted an "oversight". Nonetheless, from the documentary evidence it seemed to us more likely than not that CSL was owned by Shafqat Dad until on or around 29 August 2006. It was also clear that the company's issued share capital never exceeded £100.

39. CSL applied to be registered for VAT by submitting Form VAT 1 on 15 September 2004. It was Shafqat Dad who was responsible for the VAT registration process. It was stated that the company would be making pharmaceutical supplies and that the estimated value of taxable supplies in the following 12 months would be £100,000. Box 25 relating to anticipated sales and purchases with other EC member states was left blank. CSL indicated that it was likely to be in a VAT repayment position.

Crotek Limited

40. CL was incorporated as a limited company on 16 July 2003. The company's name was Jenny's Limited and this was changed to Crotek Limited on 23 June 2005. CL shared the same registered address as CSL in High Wycombe, Buckinghamshire.

41. For the periods material to these appeals, there were two directors: Mr Safdar Dad and his sister-in-law Frieda Dad. Mr Dad's brother, Mr Shafqat Dad, had previously been CL's sole director but resigned as a director on 17 June 2005 when his brother was appointed as a director.

42. The shareholdings in CL were unclear. The annual return dated 7 August 2006 indicated that "F Dad" (presumably Frieda Dad) had transferred 99 ordinary shares, although the name of the transferee was not stated. The return also stated that "S Dad" had transferred one ordinary share and gave Mr Dad's address in High Wycombe.

43. The annual return dated 13 August 2007 shows that Mr Dad and Frieda Dad each owned 50 £1 ordinary shares of the company's £100 issued share capital. Mr Dad stated that he had bought the company from his brother. At any rate, it was clear that the company's issued ordinary share capital never exceeded £100.

44. Mr Dad completed Form VAT 1 on 1 August 2005, applying for VAT registration. The Form stated that the company would be making supplies of "retail electronics". It also stated that the first taxable supply had been made on 1 July 2005. The annual turnover was anticipated to be £125,000. Box 25 on Form VAT 1, relating to the value of goods anticipated to be brought or sold with other EC member states, was left blank. The Form indicated that CL was likely to be in a VAT repayment position – this would have been an unlikely outcome if CL was really engaged in the trade of retail electronics.

Mr Safdar Dad

45. Mr Dad was a director of both Appellant companies at all times material to these appeals. As already noted, it was accepted by the parties that Mr Dad was the controlling mind of both companies.

46. After leaving school in June 1987, Mr Dad undertook an apprenticeship in electronic engineering. In 1994 he took a position with international electronics wholesaler called Globalsource, the principal trading activity of which was importing and exporting electronic computer chips. Mr Dad left Globalsource and between 1996 and 2000 continued to work in the electronic products sector, specialising in export sales.

47. In 2000, Mr Dad changed his career direction and became a financial adviser for an estate agency called Connells. Connells supported Mr Dad in obtaining the necessary qualifications.

48. From 2002, Mr Dad was a self-employed mortgage consultant. His only retail experience was in running a small newspaper kiosk.

Commencement of the Appellants' businesses and early contact with HMRC

Crotek Systems Limited

49. In 2004, Mr Dad decided to set up a high street mortgage business. Together with a Mr Stephen Biggs, Mr Dad, through a company called Pebble Rose Limited, bought a shop at 14 High Street, Aylesbury in November 2004. The acquisition price was approximately £230,000 and was financed by a mortgage (which, Mr Dad stated, had a high loan to value ratio).

50. According to Mr Dad's evidence, the local planning authorities required that the ground floor of the shop should be used for retail purposes and only the upper floor could be used for the mortgage business.

51. Mr Dad's evidence was that in order to utilise the downstairs retail area, he decided to sublet the space to CSL and retail mobile phones to the general public. He explained that, at that stage, his intention was to use CSL for the sale of mobile phones, while retaining CL as a more general supplier of other electronic devices. However, we note that Mr Dad was not a director and most probably was not a shareholder of CL at that time.

52. Mr Nigel Saunders, the HMRC officer responsible for both Appellants, visited CSL's premises (CL was not at this stage registered for VAT) on 7 December 2004 and met Mr Dad. Mr Dad confirmed that CSL would not be making pharmaceutical supplies but would be making retail and wholesale supplies of mobile phones.

53. On the question of the statements in CSL's application for registration for VAT as regards the intention to make pharmaceutical supplies, Mr Dad in his witness statement said:

> "CSL was initially intended to trade in pharmaceuticals however the plans never took off once we realised the pharmaceutical trade required licensing and testing of products and considerable red tape all at considerable costs."

54. In cross-examination, however, Mr Dad appeared to contradict himself:

> "Q: If I have understood this, and tell me if I have this wrong, you knew nothing about the fact that this company was incorporated as a pharmaceutical supplies company at the time?
>
> A: That is correct."

55. We concluded that Mr Dad was less than frank about this understanding of the significance of the trade category under which CSL had originally been registered for VAT.

56. At their meeting on 7 December 2004, Mr Dad told Mr Saunders that the supplies of mobile telephones would be made under a franchise agreement with a company called Mobizone Limited, a subsidiary of European Telecom Plc ("European Telecom"). Mr Shafqat Dad had been an employee of European Telecom, working as

their financial controller for two years. Mr Dad also told Mr Saunders that he had no experience of the mobile telephone industry.

57. Mr Saunders asked Mr Dad why he had opened a freight forwarder account and was informed that he had been advised to do so by European Telecom.

58. As noted above, on Form VAT 1 Mr Shafqat Dad had indicated that CSL would be a repayment trader. On 21 January 2005, Mr Saunders wrote to CSL noting that the business would normally pay VAT to HMRC and informing CSL that he was arranging for its VAT returns to be switched from monthly returns (which were normal for a repayment trader) to a three monthly cycle. On 24 January 2005, Mr Dad sent an e-mail to a colleague of Mr Saunders, Mr Owen Lloyd, stating that his business would be in a repayment position every month and asked to remain on monthly returns. Mr Lloyd replied on 24 January asking that CSL set out why it would be in a repayment position and asking for evidence to support that claim. Mr Dad (i.e. Mr Safdar Dad) replied on 25 January 2005 stating:

> "… We have relationships with many countries from Australia to the USA. Please find enclosed a list of five pages of companies to whom we will be supplying. We will be buying in the UK and exporting to these overseas companies.
>
> We understand that monthly returns are for companies who receive regular repayments from HMC&E [HMRC]. This will apply in our case as we will be exporting every month and therefore will be in a repayment situation for the foreseeable future and beyond. We do not foresee our business normally paying VAT to HMC&E due to our exports."

59. Mr Dad's letter was dated approximately one month before CSL's first wholesale mobile phone deal. In cross-examination Mr Dad was asked for details of the "relationships" with the companies to which he referred in his letter. Mr Dad accepted that he had not at that time concluded any deals with the companies referred to in the letter. He also accepted that these were companies to whom he "hoped" to make supplies. He conceded that he did not have specific relationships with any of the businesses referred to in the list. He said that he may have engaged in some "exploratory undertakings" with these companies.

60. On 2 February 2005 Mr Lloyd (together with a colleague) visited CSL to consider Mr Dad's request in his letter dated 25 January 2005 that CSL should remain on monthly returns. Mr Dad provided a list purporting to be a list of potential foreign customers together with copies of enquiries from other potential customers outside the UK. A check of the www.NextGSM.com website on 3 February 2005 indicated that the list of traders had been copied from its database as the companies appeared in the same order. The enquiries that Mr Dad provided contained mainly greetings and request for quotes, although one asked about a mobile telephone advertised on IPT .Com for sale. Following the meeting, Mr Lloyd wrote to CSL on 4 February 2005 confirming that the company could remain on monthly VAT returns.

61. In our view, it was clear that Mr Dad did not have relationships with these companies and that the letter of 25 January 2005 was deliberately misleading .We found Mr Dad's explanation unconvincing and evasive. That letter was plainly intended to justify the retention of monthly returns and the letter contained misleading information. It was clear that there were no existing relationships with these companies and, indeed, Mr Dad was unable to point to any subsequent transactions concluded by CSL with these companies. Mr Saunders's evidence, which was not challenged, was that, of the companies on the list, very few if any were supplied by either CSL or CL.

Crotek Limited

62. As noted above, CL applied for VAT registration on 1 August 2005 stating that its business activity was "retail electronics".

63. Mr Saunders (together with a colleague) visited CL's premises (the same as those of CSL) on 2 September 2005 and asked Mr Dad about the new business. Mr Dad informed him that he was intending to supply Sony PlayStations, handheld consoles and other handheld electronic devices and that he would be retailing and wholesaling them from the shop premises. At the time there were no customers and no suppliers. The new business would be financed from the profits from CSL. Mr Dad was not certain about the amount of capital required for the new business but thought it was between £10,000 and £20,000. Mr Saunders said that he was not satisfied that at that time there was a business that could be registered or a clear intent to trade. He pointed out that the statement made on the VAT application that a taxable supply had been made on 1 July 2005 was not correct.

64. At a further visit by Mr Saunders to CL's premises on 13 September 2005, Mr Dad confirmed that the main business activity of CL would be the retail and wholesale of gaming devices such as PSP, Nintendo and software. Mr Dad said that initially he would only deal in Nintendo goods and that, when supplied, the goods would be held at a freight forwarder's premises. Mr Dad produced a letter from Nintendo dated 8 September 2005 setting out terms of trade. The letter was unusual because, although it was addressed to Mr Dad, there was no personalised salutation and the letter was unsigned. Mr Saunders thought this was strange because the letter was setting out possible terms of trade. In cross-examination Mr Saunders conceded that he had not contacted Nintendo to ascertain whether the letter was genuine. In cross-examination Mr Dad accepted that he had not reached an agreement with Nintendo.

65. CL's Form VAT 1 stated that CL had made its first supply on 1 July 2005, but no paperwork was ever produced to substantiate this claim and, as noted, Mr Saunders pointed out to Mr Dad that the statement was incorrect. At the meeting on 13 September 2005, Mr Dad then produced paperwork to show that CL had made a wholesale phone sale to Starup Trading in Hong Kong on 6 September 2005. The transaction was for £286,806.80. This exceeded the compulsory registration threshold and accordingly HMRC were obliged to register CL for VAT.

66. In our view, CL's Form VAT 1 was misleading. The description of CL's business that was given was "retail electronics", but just over a month later CL was undertaking a significant wholesale transaction in mobile phones with Starup Trading (transaction which forced HMRC to register CL). It is, in our view, significant that this transaction came immediately after Mr Saunders had raised objections to the registration of the company. We infer that the reason for the transaction was, as HMRC allege, to force Mr Saunders to register CL. Moreover, the statement that CL had made its first supply on 1 July 2005 was untrue. Documentation to substantiate the existence of this transaction was never produced and it appears that Mr Dad made no attempt to justify the existence of this transaction.

67. At their meeting on 13 September 2005, Mr Saunders asked Mr Dad why a separate registration was needed if CL was to sell mobile phones as well as CSL. Mr Dad replied that he wanted to keep separate accounting for the two companies. In practice, as Mr Dad noted in his witness statement, CL was used to sell mobile phones if that accounting system happened to be open on his computer:

> "… the rigid distinction between the sales activities of the two companies became a little blurred."

68. As Mr Saunders noted in his witness statement, CSL and CL seemed to be used interchangeably.

69. Finally, in relation to the meeting of 13 September 2005, Mr Saunders reminded Mr Dad of the problems caused by MTIC fraud and he was again issued with HMRC Notices 726 and 700/52.

Mr Dad's alleged general awareness of MTIC fraud

70. Mr Saunders' s evidence was that Mr Dad had been told about MTIC fraud or had had the fraud brought to his attention during visits from HMRC officers on 7 September 2004, 17 January 2005, 17 May 2005, 13 June 2005, 13 September 2005 and 23 January 2006.

71. Mr Saunders also gave evidence to the effect that a number of joint and several liability warning letters were hand-delivered by him to CSL, at a meeting on 23 January 2006, drawing attention to tax losses in deal chains for various VAT periods. These letters explained that if the Appellant knew or had reasonable grounds to suspect that VAT would go unpaid the joint and several liability measure could be applied.

72. The letters identified those deals which had been traced back to defaulting traders. Importantly, the letters noted that the trader should be able to establish, from its records, which supplier had supplied it with the relevant goods and suggested that the trader may wish to consider what appropriate action was needed to ensure that VAT did not go unpaid in respect of any future transactions.

73. The letter in relation to the period 04/05 was dated 23 January 2006 i.e. shortly before the first transactions to which these appeals relate. That letter notified CSL that of the seven transactions selected for verification in that period all the transactions

commenced with defaulting traders and resulted in a loss of revenue exceeding £648,000. In some of those transactions CSL played the role of broker and in others that of a buffer trader.

74. The letters in respect of the other periods were similar. In respect of the period 05/05, CSL was warned, also by a letter dated 23rd of January 2006 that four out of five transactions selected for verification commenced with defaulting traders, resulting in a loss of revenue exceeding £200,000.

75. The letter in respect of period 06/05 was also dated 23 January 2006. This explained that one transaction out of six transactions selected for verification commenced with a defaulting trader and resulted in a loss of revenue exceeding £70,000.

76. A letter, also dated 23 January 2006, notified CSL that in respect of period 08/05 one transaction out of the four transactions selected for verification commenced with a defaulting trader and resulted in a loss of revenue exceeding £84,000.

77. A final letter dated 23 January 2006 in respect of the period 09/05 notified CSL that, out of five transactions selected for verification, two commenced with defaulting traders and resulted in a loss of revenue exceeding £118,000.

78. After these letters had been sent to CSL, a letter was received from solicitors acting for CSL and CL dated 7 February 2006. The letter referred to the joint and several warning letters and stated that their client had "considered that information carefully."

79. CSL was also sent a joint and several liability warning letter in respect of period 10/05 on 25 January 2006 i.e. shortly before the first deal for the periods which form the subject matter of these appeals. The letter notified CSL that of the two transactions examined both commenced with a defaulting trader resulting in a loss of revenue exceeding £145,450.

80. Finally, a further joint and several liability warning letter was sent to CSL on 1 March 2006 in respect of the period 11/05 noting that of the four transactions selected for verification, one commenced with a defaulting trader resulting in a loss of revenue exceeding £78,000.

81. As we shall see later, Mr Dad continued to deal with some of the same suppliers who had supplied him in respect of deals which were the subject matter of these joint and several liability warning letters.

82. On 8 December 2004 CSL was sent a letter from Rod Stone of HMRC's Redhill office advising of the difficulties faced by HMRC in respect of MTIC fraud and advising that the verification of the VAT status of new customers and suppliers should be cleared through the Redhill office. A similar letter was sent on 21 September 2005. This letter was sent to large numbers of traders in the mobile phone and computer component sectors and is often referred to as the "Redhill letter". HMRC’s Notice 726 (Joint and Several Liability) was enclosed with those letters as a

matter of course. Mr Dad acknowledged receiving the letter from Redhill dated 8 December 2004.

83. Notice 726 was also issued to Mr Dad, as noted above, on 17 May 2005. Notice 726 was also re-issued to Mr Dad on 13 September 2005.

84. So-called "veto letters" were sent by HMRC to CSL notifying the Appellant that certain companies in the same trade sector as the Appellant had been deregistered. The letters were dated 15 March 2005, 22 April 2005, 8 August 2005, 9 August 2005, 6 September 2005 (two letters), 24 November 2005, 7 December 2005, 12 December 2005, 5 January 2006, 11 January 2006, 12 January 2006 25 January 2006, 6 February 2006, 9 February 2006, 16 February 2006, 28 February 2006, 16 March 2006, 21 March 2006, 30 March 2006, 3 April 2006, and 20 April 2006. The letters were in standard form and the first letter of 15 March 2005 from Mr Rob Stone (who sent the Redhill letter of 8 December 2004, referred to above) at HMRC's Redhill office is typical:

> "For the attention of the Directors
>
> CROTEK SYSTEMS LTD…
>
> Dear Sir/Madam
>
> You are a trader who deals in the buying and selling of Mobile Phones, Computer Processing Units or Other Goods from the European Community and from within the United Kingdom. As part of the care and management of Value Added Tax we should bring to your attention that a Company called ADF Enterprises Ltd, VAT Registration Number: 847163806 Which Was Registered for Value Added Tax has been deregistered with effect from 01/12/04.
>
> Any input tax claimed in relation to transactions involving this company, which purported to have taken place after the effective date of cancellation of its registration, may fall to be verified. If you have any queries relating to this letter please contact Mr T Mendes [telephone number supplied]
>
> Yours faithfully
>
> Mr R Stone
>
> Tax Operations Manager
>
> Redhill VAT Office"

85. The veto letters exhibited to Mr Saunders's witness statement were sent by one of three different HMRC officers. The last 10 letters were sent by a Mr P R Birchfield who was described in the letter as belonging to the "South MTIC Division."

86. Mr Saunders's statement that the veto letters would have repeatedly brought the issue of MTIC fraud the attention of CSL was challenged by Mr Kramer on behalf of the Appellants. Mr Kramer pointed out that the veto letters did not, on their face, refer to fraud. Mr Saunders accepted that the letters did not refer to fraud. However in re-examination Mr Saunders stated that clearing VAT numbers through the Redhill

office was something that every dealer requested to do (and it was not disputed that CSL had received a "Redhill letter").

87. We also note that the first veto letter was sent by Mr Stone (the same person who sent the "Redhill letter" to CSL on 8 December 2004 which had clearly explained the difficulties faced by HMRC in relation to MTIC fraud). Moreover, the final 10 letters in the sequence of veto letters were plainly sent by a member of the "South MTIC Division". It was, therefore, clear to us that although these veto letters did not explicitly use the word "fraud" they were, by clear implication, dealing with deregistration in the context of MTIC fraud rather than deregistration for a more routine reason (e.g. cessation of trade).

88. We also note that CL received a "Redhill letter" dated 21 September 2005 in essentially the same terms as a letter sent to CSL on 8 December 2004. Moreover, on 22 December 2005, Mr Saunders wrote to Mr Dad in respect of CSL noting that Mr Dad had "not been contacting Redhill in order to verify the VAT details of traders registered in other member states." Mr Saunders asked Mr Dad to ensure that all EU VAT registration details were "verified via Redhill."

89. We concluded that Mr Dad was well aware of the risks of MTIC fraud in his trade sector before he entered into the first of the transactions which are the subject of the present appeals.

Expert evidence on the grey market

Application to exclude Mr Fletcher's evidence

90. Expert evidence was given by Mr John Fletcher, a director in KPMG LLP's London office, in relation to mobile phone handset distribution in the authorised and grey markets in 2006.

91. Mr Kramer applied to exclude Mr Fletcher's evidence on the following basis:

(1) Mr Fletcher's career history (as set out in his witness statement) did not qualify him as an expert in the grey market in respect of mobile telephones.

(2) There was no body of expertise on the mobile telephone grey market.

(3) The existence or characteristics of the grey market in respect of mobile telephones was not an issue for determination by the Tribunal since it was not referred to in the decision letters under appeal or in HMRC's Statement of Case.

92. Mr Kramer relied on the judgment of Evans-Lombe J in *Liverpool Roman Catholic Archdiocesan Trust v Goldberg* [2001] All ER (D) 75 and in particular on paragraph 7:

> " The authorities show that to qualify as expert evidence within section 3, the party seeking to call the evidence must satisfy the Court of the existence of a body of expertise governed by recognised standards or rules of conduct capable of influencing the Court's decision on any of the issues which it has to decide and that the witness

> to be called has a sufficient familiarity with and knowledge of the expertise in question to render his opinion potentially of value in resolving any of those issues."

93. Mr Parroy submitted that the admissibility of evidence was governed by Rule 15 (2) of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Tribunal Rules") which provides:

> "The Tribunal may—
>
> (a) admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom; or
>
> (b) exclude evidence that would otherwise be admissible where—
>
> (i) the evidence was not provided within the time allowed by a direction or a practice direction;
>
> (ii) the evidence was otherwise provided in a manner that did not comply with a direction or a practice direction; or
>
> (iii) it would otherwise be unfair to admit the evidence. "

94. In Mr Parroy's submission the Tribunal was not bound by the Civil Procedure Rules and that it was a matter for the Tribunal to determine what evidence should be admitted. Guidance could be obtained from the authorities. However, the *Goldberg* case relied on by Mr Kramer was primarily an authority relevant to determining whether an expert witness was truly independent and this point was not in issue in the present case. Mr Parroy cited the decision of the South Australian Supreme Court in *R v Bonython* (1984) 38 SASR 45 (referred to in *Phipson On Evidence* (17th edition) as the "classic statement as to the test of admissibility" in respect of competency of expert evidence) where King CJ said that there were two questions for the judge to decide:

> "The first is whether the subject matter of the opinion falls within the class of subjects upon which expert testimony is permissible. This… may be divided into two parts: (a) whether the subject matter of the opinion is such that a person without instruction or experience in the area of knowledge of human experience would be able to form a sound judgement on the matter without the assistance of witnesses possessing special knowledge or experience in the area, and (b) whether the subject matter of the opinion forms part of the body of knowledge or experience which is sufficiently organised or recognised to be accepted as a reliable body of knowledge or experience, a special acquaintance with which by the witness would render his opinion of assistance to the court. The second question is whether the witness has acquired by study or experience sufficient knowledge of the subject to render his opinion of value in resolving the issues before the court."

95. Mr Parroy also drew attention to a passage in *Phipson.* After quoting the above passage from *Bonython, Phipson* at paragraph 33 – 62 says:

> "In some cases, the reliability of the evidence might be relevant to whether the conditions of admissibility are met. However, in itself reliability goes to weight. There is no requirement as to admissibility

> that the evidence must be seen to be reliable because the methods used are sufficiently explained to be tested in cross-examination and so to be verifiable or falsifiable."

96. Secondly, Mr Parroy submitted that the objection to Mr Fletcher's evidence should have been taken at a much earlier stage and should not be left until the hearing of the appeal. The fact that Mr Kramer had only recently been instructed was irrelevant because Mr Fletcher's witness statement had been in the Appellants' hands for over a year.

97. As regards Mr Fletcher's expertise, Mr Parroy referred to paragraph 1.2 of Mr Fletcher's witness statement which read as follows:

> "I have been employed by the parent company of several Servers Providers ("SPs") and Mobile Network Operators ("MMOs"), in addition to my recent work as a consultant. My operational and advisory experience has provided me with a detailed understanding of MNOs and the role they play in the mobile handset distribution segment.
>
> My work has involved the examination of distribution channels for handsets in numerous markets in Western and Central Europe, the Middle East, and Asia. This work has looked at the structure of distribution networks, consumer preferences and the use of handset subsidy to stimulate demand. As part of this work, I have met with Original Equipment Manufacturers ("OEMs"), distributors and retailers in several countries to discuss local market conditions. I have direct experience from markets in the Middle East (Iran, Lebanon, Oman and the UAE) of handsets being purchased on the international grey market and imported into these markets.
>
> I have been involved in the design and performance of audits, reviewing the effectiveness of controls designed to minimise the risk of phones sold with handset subsidy being reconfigured (i.e. unlocked) to allow them to be used on any suitable GSM network. This work involved visiting retailers, interviewing their staff, and performing checks on the effectiveness of their controls and the accuracy of their documentation. I have undertaken work of this nature in the UK, France and Germany.
>
> I have advised Dial-A-Phone and the UK's largest mobile handset direct sales operator on the strategy of its business development. Specifically this work considered the client's response to the changing mix of prepaid and postpaid ("contract") customers and the likely impact that this would have on its revenue, a significant proportion of which was derived from commissions paid by MNOs to connect new customers.
>
> My experience has also provided me with first-hand insight into the varying international consumer preferences for handsets, features and formats."

98. Therefore, in Mr Parroy's submission the question was essentially one of weight. As he put it if ordinary people would be assisted by evidence from someone who is

more knowledgeable the evidence is primer facie admissible if the witness has sufficient experience. He submitted that Mr Fletcher clearly had sufficient experience. Moreover, the distribution of mobile telephones in the authorised and grey market was an area in which most lay people did not have sufficient expertise to be able to form an independent view without assistance. Rule 15 entitled the Tribunal to admit the evidence and, after cross-examination, to decide what weight should be given to it.

99. We decided that Mr Fletcher's evidence should be admitted. We considered that Mr Fletcher was suitably qualified by his experience to assist the Tribunal in an area where specialist expertise would, in our view, be of benefit to the Tribunal. As regards the issue whether evidence in relation to the grey market had been pleaded in the Statement of Case, we considered that HMRC had plainly pleaded that the Appellants' transactions "were artificially contrived and fraudulent nature as opposed to being genuine commercial transactions taking place within a competitive market". It is true that the Statement of Case does not particularise evidence relating to the grey market in mobile phones. But we do not think that a Statement of Case must particularise every item of evidence that is being put forward to support the main thrust of the Respondents' case. Moreover, the Appellants had had Mr Fletcher's witness statement for a considerable time and it was obvious that HMRC were intending to rely on this evidence to support their basic proposition that the Appellants knew or ought to have known that their transactions were connected with the fraudulent evasion of VAT. Applying the overriding principle of dealing with cases fairly and justly, as we are required to do by the Tribunal Rules, we did not consider that the Appellants could claim to have been unfairly or unjustly prejudiced. For that reason, we decided that the evidence of Mr Fletcher should be admitted. We also accepted Mr Parroy's submission that the weight to be attached to expert evidence was a matter for the Tribunal.

100. As we have noted above, the application to exclude Mr Fletcher's evidence should have been made at the PTR on 11 April 2011. Indeed, it should have been made very much earlier than that. Mr Kramer brought to our attention the *Goldberg* case (the earlier decision of Neuberger J), where the question of admissibility of expert evidence was held over to be determined by the trial judge. We consider that the issues raised in that case were different from those in the present appeal and do not derive much assistance from that decision, save as mentioned below. We were conscious that a late application to exclude expert evidence can mean that the party seeking to adduce the evidence is denied the opportunity to bring forward alternative suitable expert evidence. This is hardly fair or just. In such circumstances, we consider that it is fairer to admit the evidence and leave it to the Tribunal to decide the weight that should be attached to it. This approach commended itself to Neuberger J in earlier proceedings in the *Goldberg* case.

Mr Fletcher's evidence

101. As noted above, Mr Fletcher appeared as an expert witness called by HMRC.

102. Mr Fletcher set out in the appendices to his first witness statement (his second witness statement made certain relatively minor amendments to his first witness statement) the documents which he had relied upon in preparing his witness

statement. These documents included the deal documentation for the 43 deals (i.e. the appealed transactions and the un-appealed transactions), the Appellants' Notice of Appeal, HMRC's Statement of Case, the second witness statement of Mr Dad and the Appellants' VAT returns for the relevant periods. Mr Fletcher had not independently verified this documentation.

103. His evidence was that the Appellants appeared to be trading primarily as mobile handset distributors. The mobile handset distribution industry consisted of a white market and a grey market. The grey market resulted from opportunities to profit from the failure of the white market fully to meet the needs of certain market participants.

104. It was common ground that the Appellants' transactions were not part of the white market. The white market in mobile telephone handsets comprised of two types of trading: first, trading directly between OEMs and MNOs and, secondly, trading directly between OEMs and Authorised Distributors ("ADs").

105. The two main types of market failures in the white market which gave rise to grey market opportunities were as follows.

106. Firstly there were price-related market failures. Nokia's policy at the time was to set identical prices for its wholesale customers in all geographical markets. In its European market Nokia priced its handsets in Euros and converted those prices to sterling for the UK market, using exchange rates which were reviewed and set monthly. In contrast, other OEMs (including Sony Ericsson) did not employ the same consistent pricing policy and this gave rise to international "arbitrage" i.e. buying handsets in countries where prices were lower and then exporting them to those countries where prices were higher.

107. In some markets such as the UK, MNOs subsidise handset prices. This gave rise to "box-breaking" where handsets were bought at a subsidised price in one country, then unlocked (i.e. reconfigured) and sold on in a country where the subsidy was lower..

108. The second main white market failure was volume related. Sometimes shortages arose when MNOs and large retailers underestimated demand for handsets and the OEMs were unable to supply additional handsets on a timely basis. Excess stock could arise when distributors overestimated demand or purchased surplus stock in order to receive additional volume discounts from OEMs. This stock was then "dumped" onto international markets to minimise costs.

109. Not all grey market trading opportunities were profitable and not all traders could address all opportunities. Mr Fletcher gave the example of arbitrage which had low margins but low barriers to entry. Box-breaking, on the other hand, required significant resources but could earn greater margins.

110. There were four main grey market opportunities, as follows.

111. First, box-breaking, as described above. Mr Fletcher did not consider that the Appellants were involved in box-breaking and, indeed, there was no evidence to this effect.

112. Secondly, there were some indications that the Appellants could be involved in arbitrage trading. In particular the Appellants held stock for minimal periods. Arbitrage traders would usually have distribution lines put in place to avoid the risk of orders falling through and creating unintended ownership of stock. This often resulted in "back-to-back" deals. In addition, arbitrage traders would seek to repeat transactions with their customers for as long as a pricing differential was maintained. Therefore a stable, but short distribution relationship to enable multiple, similar shipments for the same customer from the same source was required.

113. In Mr Fletcher's opinion these two positive indicators were insufficient evidence that the Appellants were engaged in rational and profitable arbitrage trading. The Appellants' transactions displayed a number of characteristics, which he described as negative indicators, that were not consistent with participation in the arbitrage market. These negative indicators were as follows:

(a) the homogenous international pricing policy of Nokia precluded the Appellants from pursuing arbitrage opportunities. A large number of the Appellants' transactions (86% by quantity) involved Nokia handsets. The Appellants' margins exceeded the profits likely to be achieved by currency fluctuations. There was no explanation why these margins were available to the Appellant in respect of trades in Nokia handsets. In cross-examination, Mr Fletcher accepted that Nokia might sell handsets to distributors at different prices depending on the level of volume discounts achieved. Nonetheless, its volume discounting policy was applied consistently throughout the European market.

(b) The Appellants traded two types of Nokia handset within six months of the first release to the public. It could have been that these handsets experienced supply restrictions in the early weeks of release so that the Appellants were profiting from an asymmetry of supply. However, this was unlikely to be the case in respect of one of the handsets in question (Nokia 9300i). he Appellants' market share for this handset in February, March and April 2006. Whilst it was possible that the other Nokia handset (N80) was affected by supply restriction, the other five models and the other Nokia handsets involved in the 43 deals subject to the appeals were not sold within the first six months of their release so that it was unlikely that an arbitrage opportunity existed because of supply restrictions.

(c) The Appellants did not source stock from OEMs or ADs. Traders failing to source stock from OEMs or ADs were unlikely to be making profits by arbitrage due to the smaller margins possible in longer supply chains. In Mr Fletcher's opinion the Appellants' deal changes were too long to maintain profitability at reasonable levels for all companies in the chains. Given that the Appellants were not purchasing from an AD the Appellants must have known that there were at least three middlemen (their supplier,

the Appellants and the Appellants' customer) in the chain adding to the cost of the handset when sold to an end consumer. None of the Appellants' UK suppliers in respect of the deals under appeal were ADs. None of the appellants customers were end users.

(d) The Appellants were trading too high a volume of specific handsets when compared to the total volume of those handsets sold through non-OEM sourced distribution channels in Europe. Given the highly fragmented and "national" nature of the handset distribution market, it was in Mr Fletcher's opinion unusual for the European (plus UAE) market share of any one distributor company to exceed 5%. In that context, Mr Fletcher found it surprising that the Appellants' market share (based on GfK data) in respect of the periods under appeal exceeded 5% on 19 occasions, representing 99% (by volume) of handsets in the 43 (which included the nine un-appealed deals) deals in question. Only in respect of one handset (Nokia N 80) was the Appellants' market share plausible and therefore consistent with rational grey market trading. Volumes of three handsets sold on four occasions by the Appellants during the periods in question were extremely unlikely: sales of the Nokia 9500 and Nokia 9300i in April, and sales of the Nokia 9500 and Samsung i 300 in May represented 370%, 284%, 199% and 367% respectively of the total distributor market for Europe and the UAE. In addition, the Appellants also dealt in more handsets than the total European market share for three models. In April 2006 the Appellants' Nokia 9500 handset sales were 133%, and their Nokia 9300i sales were 102% of the total European (plus the UAE) retail market. In May 2006 their Samsung i300 sales were 132% of the total European (plus UAE) retail market. In other words, the Appellants were claiming that their sales of three of the nine handsets sold in the 43 deals in question represented more sales than were required to satisfy customer demand in all of Europe and the UAE during the relevant months.

(e) The level of detail on the Appellants' purchase orders and invoices was inadequate and lacked the specifications necessary to ensure successful and profitable arbitrage trading. It was vital that the handset model and variant (e.g. colour) and the regions covered in the warranty (e.g. Europe) as well as the inclusion of the charger, battery, CD and manual should be specified. Failure to specify the handset could leave a trader with the cost of adapting the handset for additional languages, or inserting new software CDs or sourcing an instruction manual in the appropriate language. In none of the 43 deals was the colour of the handsets specified on the purchase order and invoices. In only six of the transactions were the geographic specification identified. In none of the deals was the PC software, the language of the manuals and software, the type of charger (two or three pin), the existence of (and the regions covered by) the warranty, specified. Mr Fletcher noted that for the 36 deals involving Nokia handsets where inspection reports recorded warranty information, 23 deals did not record the region of the warranty. In Mr Fletcher's opinion this detail appeared insufficient to give confidence that the warranty was appropriate for a customer in Europe. Four inspection reports showed the region of the

warranty as "European and African". Mr Fletcher was unaware of the existence of such a warranty. In his opinion Nokia would cover these territories by providing either a European limited warranty or a Middle Eastern and African limited warranty.

114. Mr Fletcher considered that there was no evidence that he had seen (although under cross-examination he conceded that he had not seen all the evidence relating to these appeals) to suggest that the Appellants were exploiting a grey market opportunity in volume shortages. This market opportunity had high barriers to entry, requiring strong relationships with MNOs and the ability to supply stock on an urgent basis. There was no evidence that the Appellants had strong relationships with MNOs. Satisfying a volume shortage required access to the specific type of handset required to address the market opportunity. The descriptions of the handsets traded in would be very specific, very different from the generic detail shown on purchase orders and invoices in the Appellants' deals. In addition, a trader was highly unlikely to be able to compete in relation to volume shortages without its own stock (or rapid access to the exact stock required) due to the rapid response expectations of its customers. Finally, the extraordinary volume of specific handsets dealt in by the Appellants was a negative indicator. For these reasons, Mr Fletcher considered that the Appellants were not exploiting a grey market opportunity in relation to volume shortages.

115. Finally, as regards "dumping", this was a practice usually initiated by an AD. It involved the speculative ownership of stock and was usually loss-making. Dumping usually involved single transactions where stock was sold in regions with an anticipated additional demand. Mr Fletcher considered that it was extremely unlikely that the Appellants were exploiting this grey market opportunity as the Appellants did not speculatively purchase stock, but bought and sold it on the same day. In addition, the enormous market share that the Appellants appeared to have achieved also suggested that the Appellants were not engaged in dumping.

116. Mr Fletcher considered that the presence of these negative indicators was overwhelming and, accordingly, he concluded that the Appellants' transactions in February, March, April and May 2006 were extremely unlikely to be part of the profitable arbitrage market or any other type of grey market opportunity.

117. In cross-examination Mr Kramer queried, in relation to estimations of market share, why Mr Fletcher had used data from GfK rather than information from his contacts at Nokia. GfK Retail and Technology was described by Mr Fletcher as the world's leading market research for tracking point-of-sale data in technical consumer goods and entertainment media markets. Mr Fletcher added that he was not sure that Nokia would have supplied the necessary information and in any event he already had the information from GfK. The approach suggested by Mr Kramer would also have entailed Mr Fletcher approaching other manufacturers to obtain their data. It seemed to us that Mr Fletcher was entitled to use an independent source of information such as GfK. Mr Fletcher said that he had not sought to undertake an audit of the information provided by GfK but was satisfied with the quality of that information for the purposes of this report and his analysis.

118. Mr Kramer questioned Mr Fletcher's statement that the grey market in large corporate sales would not be open to the Appellants. He asked Mr Fletcher whether an independent retailer might maximise its profits by independently buying airtime from a network and, separately, buy handsets for the best price available. Mr Fletcher did not disagree with the hypothesis in theory but did not consider this to be realistic in practice. The vast majority of handsets in the UK were sold by providing a network handset and airtime for the same network. Moreover, the Appellant did not have the resources (e.g. personnel and account management) necessary to sell phones to large corporate customers. He was unaware of any large corporate customer buying its handsets independently from its airtime. Mr Fletcher accepted that he had not seen all the evidence in these appeals and in particular had only seen Mr Dad's second witness statement but he had examined all the deals currently before the Tribunal.

119. Also in cross-examination, Mr Kramer questioned Mr Fletcher about an article from "Mobile News" dating from 2009 which indicated that Carphone Warehouse may have "dumped" 67,000 mobile phones. Mr Kramer asked Mr Fletcher why he had not referred to this article in his report. Mr Fletcher explained that in his report he had made specific reference to grey market dumping by MNOs and ADs. He regretted that he had not included in the definition specialist multiple outlet retailers, such as Carphone Warehouse, but he thought it was clear from the diagram contained in his second witness statement that he was also referring to such specialist multiples. Moreover, the "Mobile News" article relating to Carphone Warehouse concerned 2009, whereas Mr Fletcher's report related to 2006.

120. On the question of generic product descriptions in purchase orders and invoices, Mr Kramer put it to Mr Fletcher that if there was mutual trust between the customer and supplier it was not beyond the bounds of possibility that there would be no need for comprehensive descriptions, accepting that it might be foolhardy business practice. Mr Fletcher agreed. It was not something that he would recommend but it was possible.

121. Mr Fletcher accepted that the man in the street would not know about the existence of GfK, but he would expect someone involved in the trading of mobile phones to be aware of market research available from that company.

122. Mr Kramer put it to Mr Fletcher that because he had not reviewed all the evidence before the tribunal he did not have adequate information to express his opinion on whether the Appellants were exploiting a grey market opportunity in relation to volume shortages. Mr Fletcher disagreed and considered that he had sufficient information to reach an opinion as an expert.

123. Mr Fletcher seemed to us a reliable and knowledgeable witness. We accept his evidence. Our conclusion is that the Appellants' transactions did not form part of legitimate grey market trading in mobile telephones. We accept Mr Fletcher's conclusions and his reasons in this regard. We also considered that the information considered by Mr Fletcher was sufficient to allow him reasonably to reach his conclusions.

Deal 25 – purchase from Datakey

124. On 17 May 2006, CSL purchased 2910 Nokia 8800 mobile phones from Datakey Products Limited ("Datakey") for a total price (including VAT) of £1,248,026.25 (Deal 25). CSL made a payment of £1,244,607 annotated "full 1321", obviously referring to the invoice number. Although it appears that CSL were attempting to pay in full, the payment was insufficient. Later that day a further payment of £3,419.25 was made by CSL to Datakey and annotated "Balance inv 1321".

125. Datakey had brought the same quantity of Nokia 8800 mobile phones from Bluewire Connections Limited ("Bluewire") on the same day for £1,244,607.

126. CSL, therefore, had originally paid Datakey the exact amount which Datakey owed to its supplier, Bluewire. HMRC submitted that the chances of CSL inadvertently paying its supplier the exact sum that the supplier had paid its own supplier for the goods was infinitely small. It indicated that CSL must have had detailed knowledge of the overall deal chain i.e. more knowledge than any legitimate trader would have. Mr Parroy suggested that Mr Dad had made a mistake: he had paid Datakey not the amount that he was supposed to have paid them but the amount the Datakey was supposed to be paying Bluewire. A balancing payment was then paid by CSL to Datakey to pay Datakey's mark-up. This was, in Mr Parroy's submission, wholly inconsistent with Mr Dad's evidence that he was only aware of his own contracts. He should have known whom he was buying from and whom he was selling to, and the amounts paid to and by, respectively, his immediate supplier and customer. He appeared to know more.

127. In cross-examination, Mr Parroy put the following questions to Mr Dad:

> "Q Did you know how much Bluewire were paid by Datakey?
>
> A How was I supposed to know? And the answer to that question is no….
>
> Q [Mr Parroy shows Mr Dad the documents relating to the payments and the invoices] How has that happened?
>
> A I suspect it may have been a typographical error.
>
> Q A typo?
>
> A Yes
>
> Q…. £1,244,607 is what Bluewire are invoicing your supplier, Datakey. And that is precisely the same figure, to the penny, which you pay Datakey. Can you explain that for us?
>
> A Yes, I paid Datakey. I didn't pay Bluewire so I fail to see the connection here, or the relevance.
>
> [Mr Parroy explains the sequence of payments again to Mr Dad]
>
> Q If what you have told us has a word of truth about it, there is no way that you can know what Bluewire are owed by Datakey. Are we agreed?

A That is correct.

Q So, you explain to this Tribunal, please, how it comes to be that you pay Datakey exactly what Datakey owes Bluewire?

A There could be 101 valid reasons.

Q Give me one?

A trying to think back five or six years ago, working in many busy environments; is it possible that Datakey originally sent the incorrect invoice amount to Crotek Systems?

Q Can you show me any paperwork in your possession that has £1,244,607 as being what you owe Datakey?

A Can we go through the deal paperwork in the files?

Q You are looking at the deal paperwork that you produced to Customs.

A No, sorry, I am looking at an invoice and I am looking at a transaction report. The deal paperwork would have been Crotek Systems' paperwork.

Q You are looking at it.

A I suspect this is just a genuine error.

Q Explain to me, please, "a genuine error"? You are paying the exact price that Datakey owe Bluewire, not something close to it?

A No doubt –

Q But down to the penny accurate?

A No doubt Datakey may have sent the incorrect invoice, at that time.

Q We have the invoice, we have just looked at it….

A This could be the subsequent one, prior.

Q If you look at page 431… Narrative: "full 1321". What is the invoice number on page 416?

A Does this tell us that it's a first copies [sic] – sorry, a first amendment, second amendment?

Q It doesn't say anything about amendments at all. It just says its invoice number 1321?

A And first amendments, second amendment.

Q What first amendment, second amendment?

A Did they invoice Crotek Systems incorrectly?

Q Mr Dad, this is your case. This is an issue that is raised by Mr Saunders in his statement. Have you any paperwork to show this Tribunal that explains how you apparently know the price that Datakey have paid to Bluewire?

A The bundles were prepared by HMRC. The bundles arrived at – to my solicitors. Please do correct me if I'm wrong.

Q 2009?

A No.

Q That is when Mr Saunders's statement with its exhibits was served on you.

128. We consider that the payment by CSL to Datakey of the exact amount owed by Datakey to Bluewire is important and revealing. It clearly demonstrates that Mr Dad knew more about the transaction chain than he claimed. Mr Dad claimed only to know about the transactions with his immediate supplier and his customer. In our view, this was plainly untrue. It was highly improbable that Mr Dad could have arranged a payment to Datakey in the exact amount owed by Datakey to Bluewire without having more extensive knowledge of the deal chain. Mr Dad's responses under cross-examination were, in our view, evasive and untruthful. We do not accept the suggestion that there were different original documents. No evidence was produced to substantiate the suggestion and, indeed, the documents produced in evidence make it improbable that there were other invoices. We consider that this is an important piece of evidence which, when viewed in the context of the evidence as a whole, indicates that the Appellants had actual knowledge that their transactions were connected to the fraudulent evasion of VAT.

Trading patterns and trading behaviour of the Appellants

Deals traced back to defaulting traders

129. All of the 34 deals under appeal in the periods 02/06, 03/06, 04/06 and 05/06 traced back along the relevant deal chains to defaulting traders. The Appellant was the broker in each of these deal chains. Nine deals covered by the un-appealed decision of 29 August 2006 also traced back to defaulting traders.

130. As can be seen from Appendix 1 to this decision, there are 11 different defaulting traders in the deal chains. It was accepted by the Appellants that all the deals under appeal traced back to the fraudulent evasion of VAT by the defaulting traders. Mr Saunders (as well of the responsible HMRC officers for the traders concerned) gave evidence in relation to the defaulting traders. Mr Saunders's evidence (and that of the other officers – except on certain points described below, Ms Hirons) was not challenged. The defaulting traders and the amounts of unpaid VAT owing to HMRC are as follows.

(a) Bullfinch Systems Limited ("Bullfinch")

Bullfinch was the defaulting trader in three deals under appeal (and one deal covered by the un-appealed decision of 29 August 2006). Bullfinch was deregistered with effect from 13 May 2006 owing £51,613,591.16. This sum is still outstanding.

(b) FX Drona Limited ("FX Drona")

FX Drona was the defaulting trader in one appealed deal. FX Drona was deregistered with effect from 6 April 2006 and the sum of £33,529,656.85 is still outstanding to HMRC.

(c) Mid West Communications Limited ("Mid West")

Mid West was the defaulting trader in six deals (and five deals covered by the un-appealed decision of 29 August 2006). Mid West was deregistered with effect from 3 May 2006 and continues to owe HMRC £58,931,430.83.

(d) Oracle UK Limited ("Oracle")

Oracle was the defaulting trader in one appealed deal (and three un-appealed deals covered by the decision of 29 August 2006). Oracle was deregistered with effect from 7 April 2006 and continues to owe HMRC £28,861,738.05.

(e) Puwar Limited ("Puwar")

Puwar was the defaulting trader in one appealed deal. Puwar was deregistered with effect from 16 February 2006 and continues to owe HMRC £74,253,091.19.

(f) Red Rose Consultancy Limited ("Red Rose")

Red Rose was the defaulting trader in one appealed deal. Red Rose was deregistered with effect from 4 March 2006 and continues to owe HMRC £3,686,051.

(g) Roble Comm Limited ("Roble Comm")

Roble Comm was the defaulting trader into appealed deals and was deregistered with effect from 24 March 2006 and continues to HMRC £25,195,599.

(h) Stella Communications UK Limited ("Stella")

Stella was the defaulting trader in for appealed deals. Stella was deregistered with effect from 31 March 2006 and continues to owe HMRC £10,409,242.

(i) Ultimate Security Agency Limited ("Ultimate")

Ultimate was the defaulting trader in five appealed deals. Ultimate was deregistered with effect from 24 February 2006 and continues to owe HMRC £63,101,478.

(j) XS Enterprise Systems Limited ("XS Enterprise")

XS Enterprise was the defaulting trader in seven appealed deals. XS Enterprise was deregistered with effect from the 20 May 2006 and continues to owe HMRC in excess of £45million.

(h) Zoom Products Limited ("Zoom")

Zoom was the defaulting trader in three appealed deals. Zoom was deregistered with effect from 15 March 2006 and continues to owe HMRC £74,596,848.

131. As noted above, the Appellants did not challenge the fact that the above amounts of VAT were tax losses arising from fraudulent evasion.

132. The HMRC officers who were allocated responsibility for the above defaulting traders gave witness statement evidence which (with the exception of Susan Hirons, the officer responsible for Zoom) was not challenged.

133. In relation to Zoom, Ms Hirons was cross-examined on three main points.

134. First, it was put to her that HMRC could have issued a regulation 25 notice earlier than they did. Ms Hirons disagreed with this because she did not have sufficient information in her possession to issue such a notice before 13 March 2006.

135. Secondly, Mr Kramer questioned Ms Hirons about a meeting on 13 March 2006 when Ms Hirons, together with a colleague, visited Zoom's offices. She met Mr Khera, a director of Zoom, and an employee called Mr Steven Singh. Mr Khera indicated that Zoom's books and records had been taken to his accountant on 10 March 2006 (notwithstanding that HMRC by a letter dated 2 March 2006 had requested Zoom's books and records be made available at the visit). Ms Hirons asked Mr Singh if there were any records on the premises. Mr Singh produced a laptop computer and identified at least 218 transactions that had taken place during the whole of February 2006 and the first seven days of March 2006. He estimated the gross value of his transactions to be £250 million. Although requested to do so, Mr Singh could not print off or save this data to disk.

136. Mr Kramer suggested to Ms Hirons that she could have asked Mr Khera and Mr Singh to hand over the laptop computer using HMRC's powers under Schedule 11 to the Value Added Tax Act 1994. Ms Hirons replied that she was just visiting officer. She asked for the books and records and if they were offered to her she could uplift them. She did not consider that she could remove the computer.

137. Finally, Ms Hirons was cross-examined in relation to the basis on which the assessment against Zoom was made. Ms Hirons explained that the assessment figure was made up of two parts. First, the assessment was calculated on the basis of the output tax as declared by Zoom on its VAT returns and, secondly, from the figures in respect of transactions which Zoom declared as zero rated dispatches to the EU. Mr Kramer suggested to Ms Hirons that the figures in respect of goods exported could be correct i.e. that the goods were genuinely exported. Ms Hirons replied that she had seen no evidence from Zoom to support such zero rating and to support Zoom's repayment return. Zoom had not queried the assessment.

138. We were satisfied on the basis of Ms Hirons's evidence that the regulation 25 notice was issued on a timely basis. It was clear Ms Hirons did not have sufficient factual evidence to issue the notice at an earlier date. Furthermore, we were satisfied that Ms Hirons genuinely did not consider that she had power to remove the laptop computer. On the issue of whether the assessment against Zoom overstated its VAT liabilities, we could see no evidence that Zoom had exported goods to the EU to support the figures used in their VAT return. On that basis, we conclude that, for the purposes of these appeals, the assessment against Zoom (and consequently the outstanding tax) was and remains valid.

Buffer deals

139. Exhibited to Mr Saunders's witness statement were details of deals in which CL and CSL acted as buffer traders. There were 103 deals in which CL acted as a buffer

trader. CSL acted as a buffer trader in 77 deals. Mr Saunders's evidence was that all these transactions traced back to defaulting traders and fraudulent tax losses.

140. The mark-ups achieved by CSL and CL in these buffer deals were normally 50 pence per unit regardless of the stock specification or quantity.

141. In cross-examination, Mr Kramer challenged the view of Mr Saunders, that the high incidence of buffer deals which could be traced back to fraudulent defaulting traders could not be pure chance. Mr Saunders conceded that a high proportion ("vast") of mobile phone transactions in the grey market traced back to tax losses. Mr Kramer therefore suggested that, on that basis, the high incidence of the Appellants' buffer deals being traced back to tax losses could have occurred by chance. Mr Saunders disagreed.

142. Reviewing the exhibits to Mr Saunders's witness statement dealing with the Appellants' buffer deals, we noted that out of the 103 deals where CL acted as a buffer, 63 deals featured one of the 11 defaulting traders appearing in the deal chains in respect of the transactions which form the subject of these appeals (and which we have listed above). Ultimate features in 22 deals, Oracle in 20 deals, Puwar in 10 deals, Zoom in six deals, FX Drona in three deals, Bullfinch in one deal and Mid West in one deal.

143. In respect of the 77 deals in which CSL acted as a buffer, 71 deals also feature one of the 11 defaulting traders appearing in the deal chains which form the subject of these appeals. FX Drona features in 20 deals, Roble Comm in 16 deals, Bullfinch in 13 deals, Zoom in eight deals, Ultimate in seven deals, Stella in four deals, XS Enterprise in two deals and Red Rose in one deal.

144. In our view, the very high proportion of buffer deals involving the Appellants which traced back to fraudulent tax losses was unlikely to be the product of coincidence or chance. In addition, the fact that the Appellants consistently made the same mark-up, regardless of the quantity or specification of mobile phones involved, also suggests that their buffer transactions were contrived. It is hard to understand or credit how it could be possible that the same mark-up was repeatedly achieved in such a large number of deals which were supposedly made at arm's length in a vibrant commercial market. We do not believe that these deals were concluded on a genuine arm's-length basis and consider that they indicate, as part of the overall factual matrix, that the Appellants were knowingly involved in contrived transactions.

Chronological rotation of defaulting traders

145. At the hearing, HMRC produced a schedule showing both the deals and the defaulting traders appearing in each deal in chronological order. The deals included the deals covered by the un-appealed decision of 29 August 2006. Broadly speaking, the schedule showed that the defaulting traders appeared by rotation for a few deals and were then replaced by other defaulting traders. Thus, Puwar was the defaulting traders for the first (chronological) deal and was then replaced by Ultimate for the next five deals. Zoom took part in the next deal, with Red Rose appearing for the following deal and Zoom then participated in the next two deals. Roble Comm took

part in the next two deals but was replaced by Stella for the next four deals. FX Drona then took part in one deal, followed by Oracle for the next four deals, Bullfinch for the next four deals, Mid West for the next 11 deals and XS Enterprise for the final seven deals.

146. This chronology was not challenged.

147. HMRC submitted that this indicated that the deal chains were contrived. We agree, but note that this chronology does not, by itself, indicate that the Appellants were or ought to have been aware that their transactions forming part of these deal chains were connected to the fraudulent evasion of VAT.

Profit margins and mark-ups

148. The profit margins and mark-ups in the deal chains relating to the present appeals require some examination.

149. First, an unusual feature of the deal chains involved in these appeals is the consistency of the mark-ups made by the Appellants' supplier. The mark-ups for the the deals are set out in Appendix 2 . Mr Dad's evidence was that he did not know what his supplier paid for the goods which were eventually bought by one of the Appellants (see above in relation to Deal 25 involving Datakey). We concluded as a result of the documentation relating to Deal 25 that this was likely to be untrue.

150. Accepting, however, for the sake of argument that this was true, it leads to a curious result. Looking at the 34 deals under appeal and the nine deals included in the un-appealed decision of 29 August 2006 (43 deals in total), the Appellants' immediate supplier makes a mark-up of either 50 pence (in 28 deals) or £1 (in 15 deals). Elsewhere in the deal chains different mark-ups of 10 pence, 25 pence and 75 pence are often made by other participants in those chains. It is hard to credit how the Appellants, if they were negotiating with their suppliers on an arm's length basis, always inadvertently agreed on a price with its supplier which left that supplier with a mark-up of either 50 pence or £1 in every case. Although not conclusive by itself, we consider that this evidence forms part of the overall factual matrix which indicates that the Appellants knew that its transactions were contrived and were connected to the fraudulent evasion of VAT.

151. Secondly, the profit margins made by the Appellants appear remarkably consistent. Mr Saunders gave evidence in relation to the Appellants' profit margins in the form of tables attached to his witness statement. In short, in five of CL's six deals (all in April 2006 – Deals CL 1 to 6) its profit margin was 6%. In the remaining deal, CL's profit margin was 5.9%. For three of the deals the EU customer was Balsim SARL ("Balsim") and for the other three the EU customer was URTB SARL (" URTB").

152. As regards CSL, its deals in February 2006, with one exception, showed remarkably consistent profit margins. The exception was Deal 21 which showed a profit margin of 4%. However, the other deals (Deals 1, 2, 11, 12, 13 and 14) all returned a profit margin of 9%.

153. CSL's deals in March 2006, with two exceptions, showed consistent profit margins. The two exceptions were Deals 3 and 15 which showed profit margins of 4%. Of the other deals, Deals 19 and 20 showed profit margins of 8.7%, Deals 4, 5 and 18 showed profit margins of 8.8% and Deals 6, 16 and 17 profit margins of 8.9%.

154. CSL's deals in April 2006, with one exception, showed consistent profit margins. The exception was Deal 29 which returned a profit margin of 8%. Deals 7, 8, 10, 33, 36 and 37 showed profit margins of 5.9%, Deals 8, 31, 32 and 34 showed profit margins of 6% and two deals (Deal 30 and 35) showed profit margins of 6.1%.

155. CSL's deals in May 2006 also showed consistent profit margins. Deals 24 and 27 showed a profit margin of 3.9%, Deals 22, 23, 26 and 28 showed a profit margin of 4% and Deal 25 showed a profit margin of 4.1%.

156. It is hard to understand how, in an open market with parties dealing at arm's length, such consistency of profit margins could so regularly be achieved and why the average profit margin differed each month. We considered that this consistency of profit margins indicated that the Appellants' transactions were contrived rather than the product of genuine open market trading.

157. Thirdly, it is not clear why CL's and CSL's customers bought goods from the Appellants, which charged a significant mark-up, when they could have bought the goods more cheaply from other participants in the deal chain. Even allowing for the additional cost of exporting the goods there seems no logical reason why, in an open, rational and competitive market, the Appellants' customers would not have sourced their goods from a cheaper source of supply – particularly when most of the participants in the deal chains advertised on internet-based trading platforms such as IPT. Mr Dad, in his second witness statement, addresses issue and emphasised that it was the "personal relationship that seals the deal as to who is supplied the product and who is not… It is simply who we like, when you like them and how you deal with them." However, it his earlier witness statement Mr Dad in the course of explaining why he used TSP to carry out due diligence, noted: " I rarely had personal contact with my business partners and it was helpful to know that someone had visited them on my behalf …." When cross-examined on this issue Mr Dad's replies were unconvincing. He said:

> "We sell stock to Handel [CSL's customer in Deal 2]. I am sure if they could have got it cheaper elsewhere they would have done, but at that time no doubt we were offering them stock, what would have seemed competitive, and the true value of the stock for the market for these particular commodities at that time."

Trading patterns

158. Mr Dad accepted in cross-examination that trading in an open and competitive market should be a random process i.e. there should be no pattern as to whom he bought from and to whom he sold. However, in the 43 deals (including the un-appealed deals in relation to the decision letter of 29 August 2006) CL and CSL had

only eight suppliers and six customers. Mr Dad's reply was, in our view, evasive. He said:

> "I – well it has just been brought to my attention, so I don't know what to say really."

Position of Appellants in deal chains

159. In all the 43 deal chains (with one exception Deal 36 – one of the un-appealed deals) set out in Appendix 1, the Appellants are the fifth UK company in the deal chain. The defaulting trader is the first UK company and is followed by three UK buffer companies before one of the Appellants enters the chain as the broker.

160. In our view, this pattern gives rise for the clear inference that the deal chains were organised or contrived. It is very difficult to envisage circumstances in genuine open market trading where such a pattern would arise so consistently over so many transactions.

Evidence of negotiation

161. The Appellants produced no evidence of negotiation in respect of any of the 43 transactions which were the subject of the decision letters referred to earlier on this decision. Nor was any evidence of negotiation produced in respect of any of the buffer transactions in which the Appellants participated.

162. Whilst it is to be expected that many of the transactions were concluded over the telephone, by MSN Messenger or by e-mail it seems odd to us that no evidence of negotiation (e.g. telephone records, copies of e-mails or manuscript notes in day books) were produced. It is not, of course, for the Appellants to prove that they had no knowledge that their transactions were connected to VAT fraud. Nonetheless, the absence of any documentary evidence of negotiation is one factor, in the overall factual matrix, of which we can take account.

Appellants' turnover

163. The turnover of both CSL and CL grew rapidly. Mr Saunders's evidence, which was not challenged, was that in the first calendar year for CSL its turnover exceeded £41 million (the year to 31 December 2005) and its turnover for the first four months of the year to 31 December 2006 produced a turnover in excess of £78 million. The value of taxable supplies forecast on Form VAT 1 for the 12 months after registration was £100,000. CL achieved a turnover of £89 million from 8 September 2005 to 30 April 2006 – approximately 8 months. This was to be contrasted with the forecast on Form VAT 1of a 12 month turnover of £125,000. Mr Dad had no previous experience in trading mobile phones. The share capital of the Appellants was minimal, according to the audited accounts of CL for the year ended 31 July 2006 and for CSL for the year ended 31 August 2006.

164. Mr Stone's evidence was that there was a rapid increase in the volume of exports of mobile phones from the UK in the months following the decision of the European Court of Justice ("ECJ") in *Bond House Systems Limited* (C-483/03) on 12 January 2006. In that case the ECJ rejected HMRC's argument that carousel MTIC trading

was not a genuine economic activity. For example, CSL's turnover in February 2006 was more than double its turnover in January 2006 and its turnover in March 2006 (slightly more than £40 million) was more than double its February 2006 turnover. Mr Parroy submitted that there was a clear correlation between the sudden increase in turnover of the Appellants and the decision of the ECJ in the *Bond House* case and the announcement by the UK government on 26 January 2006 of its intention to apply for a derogation permitting a reverse charge on mobile phones. This increase in mobile phone trading by the Appellants was not the result of genuine commercial market conditions such as a doubling of consumer demand. Rather it was an attempt by those involved to use an opportunity for fraud before changed legislation prevented them Mr Kramer argued that the increase in certainty following the *Bond House* decision led to greater commercial activity and this was a perfectly legitimate result.

Due diligence

165. In his witness statement, Mr Dad stated that he had not had the requirement to undertake due diligence checks explained to him by HMRC. Mr Dad said:

> "19. During this period, I was generally aware from various media sources that there were some irregularities within the mobile phone industry which seems to indicate that fraud was taking place. However, in the light of the measures I was taking and the regular and stringent checks being made upon both my companies by HM Revenue and Customs, I was confident that my trades were legitimate and that I was not, even inadvertently, involved in the general fraud that I had read about. I was never directed to undertake due diligence checks, nor was I directed as to their content. I knew about the Joint & Several Liability leaflet, but its significance [was] not fully understood. HMRC and its Officers never explained the leaflet to me and I was never invited to a training seminar. I was asked at regular visits by HMRC Officers what checks had been carried out and ad hoc copies of the details of my checks were supplied as and when requested by HMRC. HMRC had not indicated to me that I had been involved in any chains of transactions that had led to VAT losses at some point in the chain.
>
> 20. I would like to point out that during all my years in business, both as an engineering salesman and financial adviser, checks on sellers such as creditworthiness checks and so on, were a natural part of conducting business for me. Furthermore, the sale of mortgages requires a degree of fiduciary care that is designed to protect both the mortgage or and the mortgagee. This was a daily routine requirement for me and I brought this level of care to my business of selling mobile phones from the outset. I now set out below the kinds of 'due diligence checks' I undertook on all the companies that I traded with."

166. In the light of the evidence of Mr Saunders, summarised above under the heading “Mr Dad's alleged general awareness of MTIC fraud”, Mr Dad's assertion that he was never directed to make you diligence checks and did not understand the Joint & Several liability Notice is difficult to understand. We consider that Mr Dad was fully aware of his responsibilities to conduct due diligence of his trading partners.

167. Mr Dad stated that he only traded with a company after he had received stamped confirmation from HMRC that the company's VAT number was valid at the time he commenced opening trade accounts. He submitted written requests to HMRC's office at Redhill. In those instances where HMRC informed him that VAT registration was invalid, he did not develop trading relationship with those companies.

168. Mr Dad's evidence was that he put together "due diligence packs" for each customer and supplier prior to dealing with them – he described these as his own "internal" due diligence. These packs included passport details, home addresses for key personnel, proof of address of the company, letters of introduction, copies of their VAT certificate, certificate of incorporation, bank account details, trade references, Companies House records and annual accounts for the most recent period.

169. Mr Dad said that he requested these details in order to enable him to judge the liquidity and credit worthiness of the supplier or customer. He felt qualified to undertake this task due to his previous training as a financial adviser.

170. Mr Dad said that he reviewed his due diligence checks on a six monthly basis and updated them as necessary. Because of cost and his growing familiarity with his suppliers and customers, he did not find it was cost-effective to carry out due diligence checks for every transaction, although he always checked the 'Europa' website for confirmation of VAT number of validity. The due diligence he had conducted in respect of his trading partners, in his view, showed them to the best of his knowledge to be legitimate business entities.

171. Mr Dad noted that when a credit check was conducted, he looked only for a poor rating or a warning not to trade. As none of his customers was offered credit terms, he did not regard a credit check as a particularly significant check. If a company was relatively new and he was unable to obtain a satisfactory credit check, as long as the other checks carried out were positive, he felt able to trade with that company.

172. Mr Dad stated that he required his suppliers to complete a "suppliers' compliance" form in respect of every purchase which the Appellants made. On this form, the supplier confirmed that the goods were not being sold at a lower price than purchased; that reasonable due diligence checks had been carried out with all their own suppliers and that there was no reason to believe that VAT had not been paid on the goods; that VAT would be declared to HMRC; that the stock existed; that no third-party payments of any kind would be entered into; and that the certificates of incorporation, VAT registration and a company introduction and letterhead had been obtained.

173. In relation to the transactions to which these appeals related, Mr Dad said that he did not know who supplied his supplier or to whom his customers sold. Therefore, his due diligence was conducted only on those parties with whom he had direct contact. In addition, Mr Dad said that he carried out due diligence checks on the freight forwarders that he used for all the transactions relevant to these appeals (AFI Logistics Limited).

174. In addition to the above measures, Mr Dad engaged in independent firm, "The Security People" ("TSP") to carry out checks on his trading partners – he described TSB's reports as "external" due diligence. TSP was an independent company the key personnel of which were, according to Mr Dad, all former Metropolitan Police or HM Customs & Excise officers. Typically, a TSP report would cost approximately £300. A check could be done within 24 hours, at a higher cost, or at seven days' notice, which was Mr Dad's usual requirement. In practice, notwithstanding Mr Dad's statement, it appeared that typically TSP reports took longer to compile than seven days.

175. Mr Dad's evidence was that TSP would visit his customer or supplier, interview the directors, photograph premises and collect directors' identification, utility bills from directors' home addresses, utility bills from trading addresses, company letterheads, suppliers' declarations, company VAT certificates and company incorporation certificates. TSP would also obtain a Companies House verification report and electoral roll report. Mr Dad considered that through the interviews conducted and the questions asked, TSP were able to inform him as to whether the companies he was trading with appeared to be legitimate businesses. Mr Dad found the TSP reports especially useful because he rarely had personal contact with his trading partners and it was helpful to know that someone had visited them on his behalf to examine their business practices. Mr Dad said that he engaged TSB to carry out an investigation once he knew a business was going to be a regular supplier or customer.

176. As regards TSP reports, a number of the reports were produced after rather than before the Appellants entered into deals with relevant trading partner. Mr Dad stated in his first witness statement:

> "I have never dealt with the company without first carrying out a due diligence check. Because my due diligence checks are regularly updated, I do not retain records of the earlier checks, but keep only the latest information on the company as this will be the only relevant information for deciding whether to conduct the next deal with it or not. At no stage did the Commissioner request or direct or even recommend me either in writing or verbally that I should retain the out of date due diligence checks even after an update had been obtained."

177. Mr Dad maintained, under cross-examination, that the TSP reports produced in the bundles for the appeals were simply the latest copies of these reports and that there would have been earlier reports. He said that the reports for each trading partner would have been continuously updated. However, Mr Dad and his advisers did not produce any earlier reports. It seemed odd to us that TSP reports, which were relevant to the Appellants' state of knowledge at the time when they entered into particular deals would not have been retained or produced, and that, if Mr Dad were to be believed, only later reports had been produced by the Appellants. We did not regard Mr Dad's assertion, which was challenged in cross-examination, to be credible. Moreover, Mr Saunders's notebook contained notes of a visit which he and a colleague paid to CSL's offices on 13 June 2005. The notebook states:

"Explained need to keep all records for six years including due diligence checks. Discussed due diligence checks."

We therefore did not accept Mr Dad's contention that he had not been asked by HMRC to retain due diligence records.

Due diligence on SLC Handelsmaaschappiij BV ("Handel")

178. In cross-examination it was put to Mr Dad that, in fact, he had not carried out any due diligence on one of CSL's customers, Handel, with which CSL entered into five transactions. In his witness statement Mr Dad said that he was unable to carry out due diligence on this customer "due to cash flow problems at the time". Mr Parroy pointed out to Mr Dad that, using information from CSL's VAT return for February 2006, CSL appeared to have made a profit of approximately £400,000 and in March 2006 had made a profit of approximately £700,000. In April 2006, according to its VAT returns, CSL made a profit of approximately £800,000. Mr Dad maintained that because the returns were repayment returns the business had little available cash at the time, although he conceded that a profit was being made. In our view, that does not explain why due diligence was not carried out in respect of the initial deals (e.g. Deal 11 on 27 February 2006 and Deal 15 on 6 March 2006). Accordingly, although Mr Dad's cash flow explanation may be plausible as regards later deals, it is not credible as regards earlier deals.

Due diligence on DGB Sarl ("DGB")

179. DGB was CSL's customer in nine appealed deals and five un-appealed deals. The first deal was Deal 21 on 9 February 2006. The last deal was Deal 24 on 17 May 2006.

180. The TSP report for DGB, produced as an exhibit to Mr Dad's witness statement, was dated 15 June 2006, four weeks after the last deal.

181. Mr Dad maintained that this was simply the most recent TSP report available and that there would have been earlier reports, but he was unable to produce an earlier one. He stated that the reports were continuously updated. We did not find this credible for the reasons given above.

182. The TSP report on DGB noted that the company had an FCIB account. It noted that DGB's suppliers were based in the UK but its customers were based in "Europe". The report noted, under the heading "Risk Assessment" (which was apparently based on a Dun & Bradstreet report) that there was: "Insufficient information to offer a credit opinion. Represents high level of risk." Mr Dad stated that all his European sales were on a "carriage, insurance paid 100% on landing" basis. He described the risk assessment as "subjective".

183. In his witness statement, Mr Dad stated that he was not concerned about the credit check for DGB as he was not extending credit to them and the goods were not to be released until payment was received. However, according to Mr Saunders's unchallenged evidence, the goods were shipped to DGB in France by CSL's freight forwarder before payment was received. For example, in Deal 21 CSL sold to DGB a quantity of 2800 Nokia 8800 handsets for £1,421,000. The goods were shipped by

AF1 to Paris on 9 February 2006 and CSL was not paid until 17th February 2006. As Mr Saunders pointed out it was important when shipping goods to a customer in a different country to establish the creditworthiness of that customer because the expenses incurred in exporting, and reimporting the goods would fall on CSL if the customer was unable to pay.

Due diligence on URTB Sarl ("URTB")

184. URTB was CSL's customer in (in chronological order) Deal 14, 11, 4, 19, 6, 8, 22, 26 and 27. The first deal took place on 20 February 2006 and the last deal took place on 18 May 2006. URTB was CL's customer in Deals CL 5, CL 6 and CL 2. The first deal involving CL took place on 24 April 2006 and the final deal took place on the following day, 25 April 2006. In total, therefore, CSL and CL undertook 12 deals with URTB in the relevant periods.

185. The TSP report in respect of URTB exhibited to Mr Dad's witness statement was dated 30 May 2006 i.e. approximately 2 weeks after CSL's last deal with URTB. Notwithstanding that date, the report refers to the VAT number of URTB being cleared with HMRC's Redhill office on 19 June 2006. It appears, therefore, that the report was completed significantly later than 30 May 2006. Therefore all the mobile phone transactions with URTB which are subject to these appeals were undertaken more than four weeks before this due diligence check had been finalised.

186. Mr Dad confirmed that he would have read the report but noted that he would only have given it a "cursory glance."

187. The report indicated that the directors of URTB, a company with a French trading address, were based in Spain. The fixed line telephone was a French number but the principal contact numbers were Spanish mobile telephone numbers. Under the heading "Products dealt in" the TSP report stated "mobile phones". In relation to the question "How do you determine the market value of the goods?" The answer was "Not provided". The same answer was given to the question "What checks do you undertake on your suppliers?" The answer to the question "Where are your suppliers based?" was left blank.

188. The TSP report asked two further questions: "Have you made third-party payments in the past?" and "Do you currently make third-party payments, if Yes what percentage of transactions? The answer to both questions was "Not provided".

189. One of the two trade references provided for URTB was Goldex International – a company controlled by Mr Dad's brother, Mr Shaftaq Dad.

190. The report indicated that the officers of URTB were based in a "furnished building with numerous offices to let. Small office within building suitable for one person."

191. In reply to a question: "Do the company directors/managers possess an adequate awareness of the industry they are trading in?" the report stated: "Difficult to ascertain having not been able to meet the director and also concern that company secretary has

not met the director." In relation to the question: "Does the company have a track record of trading in this industry or related sectors?" the report stated:

> "The Director resides in Spain and it is difficult to establish what his role as in the company except as Director. The Second Director is Mr Neyer Uzman who is also referred to as the Trade Manager. He also resides in Spain. The company Secretary was Linda Bouraoud who states she has the company secretary and also refers to herself as the sole trader. She stated that she has not ever [sic] met the director however in front of the investigator signed paperwork on his behalf as if she was the director. It is not clear whether she has the right to sign on behalf of the director but the fact she signed her name as the director could well be an issue of concern. It has not been possible to acquire a utility bill from the director's home address despite several requests. Also of note is a piece of paper that was signed by Linda as if she was a director, is a self-declaration by Mr S David [the director] that he resides [at an address in Marbella] Spain. This document has no validity as it was signed by the trader purporting to be the Director and it would have been of importance to get a person of professional standing to attest the director's address."

192. Mr Parroy questioned Mr Dad about the statements and asked whether he was concerned. Mr Dad replied that it was common in organisations for documents to be signed "pp". As regards the signature on the self-declaration, Mr Parroy suggested this was tantamount to an observation of forgery. Mr Dad replied that he could not comment "on someone else's comments." Mr Dad denied that the TSP reports were mere "window dressing". Mr Dad suggested that the report would have been just an update and further suggested that the previous copy might have been more favourable. He was, however, unable to produce an earlier report.

Due diligence on Balsim International ("Balsim")

193. Balsim was CSL's customer in six deals (including un-appealed deals). The first deal was 14 March 2006 and the last deal was 17 May 2006. Balsim was CL's customer in three deals. The first deal took place on 18 April 2006 and the last deal took place on 26 April 2006.

194. The TSP report was dated 15 June 2006. Notwithstanding this date, the report refers to a Redhill clearance on 27 June 2006, indicating that the report was not completed until that date at the earliest, six weeks after the last deal.

195. The report gives details of the home address of the director, but no details for the secretary or bank, save in respect of FCIB. There are no details in relation to accountants, auditors or solicitors and no financial details. In relation to the question: "What checks do you undertake on your suppliers?" the report states: "None." Notwithstanding this answer (and apparently unaware of the contradiction), in response to the question: "Does the company appear to have a professional approach in dealing with suppliers and customers?" the report stated: "The company appears to have a very professional approach towards customers and suppliers." The report also

stated: "This company has only been trading since January 2006 so does not have a strong track record in this sector." Mr Dad, in cross-examination, suggested that the answer "None" in relation to checks on suppliers, may have been a typo. He said he would have spoken to TSP if he had any issues or concerns. In relation to the fact that the company had only been trading since January 2006, Mr Dad stated that he could not comment on someone else's comments.

196. The TSP report also included a credit report which indicated, on the basis of a Dun & Bradstreet credit rating that Balsim's credit constituted a significant level of risk. In response, under cross-examination, Mr Dad commented simply that: "Credit reports are subjective."

197. Remarkably, the trade references provided by Balsim, notwithstanding that the report was commissioned by CSL, were to be given by "Crotek Systems" and "Goldex International" (the company run by Mr Dad's brother). When asked about this in cross-examination, Mr Dad suggested that the page may have been put in the bundle by error. Mr Parroy reminded Mr Dad that these were the exhibits to his own witness statement. Mr Dad replied that the bundle had only been provided to the Appellants in the week prior to the hearing. However, Mr Kramer confirmed that these were indeed the exhibits to Mr Dad's witness statement.

Due diligence on Calltel Telecom Limited (also trading as Callmate) ("Calltel")

198. The Appellants carried out due diligence checks on Calltel. Mr Dad carried out checks in June/July 2005, although there was no evidence of third-party references having been taken up.

199. Calltel supplied CSL in Deals 12 and 14 on 20 February 2006. The TSP report is dated 14 March 2006 at refers to Redhill checks made on 28 March 2006. Therefore, the TSP report post-dated the relevant deals by five weeks.

Due diligence on Cellular 1 Communications Limited ("Cellular")

200. Cellular was a supplier to CSL in Deals 21 (9 February 2006) and 13 (22 February 2006). No TSP report was prepared for the supplier. However, the due diligence checks carried out by the Appellants included seeing its financial statements for the year ended 30 April 2004. The balance sheet of Cellular indicated that it had a balance sheet deficit of £9640. Mr Saunders's unchallenged evidence was that tax losses had been traced for every deal chain in which CSL bought from this supplier for the periods in question.

Due diligence on Mobile Heaven Limited ("Mobile Heaven")

201. Mobile Heaven supplied CSL in Deal 1 (22nd of February 2006), Deal 3 (2 March 2006), Deal 6 (21 March 2006), Deal 7 (6 April 2006) and Deal 27 (18 May 2006). Mobile Heaven supplied CL in Deal CL 1 (21 April 2006).

202. The due diligence carried out by the Appellants on Mobile Heaven in August 2005 included obtaining their financial statements. The balance sheet for the year ended 30 June 2003 showed a balance sheet surplus of £28,990. The balance sheet for

Mobile Heaven to the year ended 30 June 2004 included in the TSP report dated 27 March 2006 showed a balance sheet surplus of £118,382.

203. On 23rd of January 2006 HMRC had advised CSL of a tax loss in a deal chain in which it had previously bought from Mobile Heaven in the period 08/05. However, there was no evidence of more up-to-date due diligence having been carried out before CSL again dealt with Mobile Heaven in February, March and April 2006.

204. As noted above, the TSP report is dated 27 March 2006 but it contains a reference to a Companies House verification report dated 20 April 2006. This indicates that the TSP report was not available until after all the transactions (except Deal 27) in which Mobile Heaven supplied CSL had been concluded i.e. Deals 1, 3, 6 and 7.

205. Mr Saunders's evidence, which was unchallenged, was that on 18 May 2006 (Deal 27) CSL purchased mobile telephones from Mobile Heaven for £723,520 plus VAT. These handsets were sold on the same day to URTB for £752,080. However, CSL did not pay Mobile Heaven until 16 June 2006 – almost one month later. On 21 April 2006 CL purchased handsets from Mobile Heaven (Deal CL 1) for £1,002,400 plus VAT. The handsets were sold by CL to Balsim on the same day for £1,062,600. CL did not pay Mobile Heaven for these mobile phones until 28 April 2006. Mr Saunders pointed out that no consideration appeared to have been given as to how –or why -Mobile Heaven could or would extend such generous credit facilities. Tax losses have been traced in every deal chain where CSL and CL bought from Mobile Heaven for the periods in question.

Inter Communications Limited ("Inter")

206. Inter supplied CSL in Deal 2 (23 February 2006) and Deal 29 (18 May 2006). Inter also supplied CL in Deal CL 2 (25 April 2006) and Deal CL 3 (26 April 2006).

207. As part of the Appellants' due diligence on Inter an abbreviated balance sheet was obtained showing a surplus of £6871 for the year ended 31 March 2004.

208. HMRC advised CSL by letter on 23 January 2006 that purchases from this supplier had been traced back to tax losses in the deal chain for the period 06/05.

209. The Appellants obtained a TSP report dated March 2006, but the contents of the report indicated that the report could not have been made available before 21 April 2006. The report was therefore produced after Deal 2.

210. Tax losses have been traced in every deal chain where CSL and CL bought from this supplier for the periods in question.

Due diligence on Datakey

211. Datakey supplied CSL in Deals 16 (14 March 2006), Deal 17 (14 March 2006), Deal 18 (20 March 2006), Deal 19 (20 March 2006 or 23 March 2006), Deal 20 (27 March 2006), Deal 22 (16 May 2006), Deal 23 (16 May 2006) and Deal 25 (17 May

2006). Datakey also supplied CSL in 8 un-appealed deals between 4 April 2006 and 27 April 2006. Datakey also supplied CL in in Deal CL 5 (24 April 2006).

212. A TSP report on Datakey was dated 11 April 2006, and the contents of the report indicates that it was not completed until 21 April 2006. The TSP report indicated that Datakey's profit and loss account for the year ended 31 December 2004 showed a trading loss and a balance sheet deficit. The company had no credit rating and at 7 October 2005, under the heading “Credit Rating”, is shown as “not trading”.

213. Tax losses have been traced in every deal chain where CSL and CL bought from Datakey in the periods in question.

Due diligence on Technology Plus limited ("Technology Plus")

214. Technology Plus supplied CSL in Deal 26 (18 May 2006). It supplied CL in Deal CL 4 (18 April 2006) and Deal CL 6 (24 April 2006).

215. The TSP report on Technology Plus was dated 16 May 2006, although the report refers to a VAT registration verification carried out on 30 May 2006. It therefore appears that the report was not available until 30 May 2006.

216. In response to the question from TSB: "What checks do you undertake on stock?" the reply was: "Confirm with freighter if stock is physical." In response to the question: "Are goods insured?" the reply was: "Now and then."

217. The company credit rating suggested credit should be limited to £9,000 and suggested further enquiry was needed.

218. Tax losses have been traced in every deal chain where CSL and CL bought from the supplier for the periods in question.

AR Communications Limited ("AR")

219. AR supplied CSL in Deal 11 (27 February 2006), Deal 4 (7 March 2006), Deal 5 (21 March 2006), Deal 8 (7 April 2006), Deal 9 (11 April 2006), Deal 10 (26 April 2006) and Deal 24 (17 May 2006).

220. The TSP report was dated 28 March 2006, but parts of the report are dated 4 April 2006, suggesting that the report was not available before that date. The report, therefore, post-dated Deals 4, 5 and 11.

221. On 17 May 2006 (Deal 24) CSL purchased handsets from AR for £745,500 plus VAT. These handsets were removed from the UK by CSL before payment had been made. There was no evidence indicating how or why this credit was made available to CSL.

222. A joint and several liability warning letter dated 1 March 2006 in respect of a supply from this trader in period 11/05 had been sent to CSL.

Due diligence and warning letters

223. As described above, CSL received warning letters from HMRC dated 23 January 2006 that a number of its transactions in VAT periods in 2005 traced back to tax losses. Those letters noted that CSL would be able to establish from its records the identity of its supplier in the relevant transactions.

224. In the case of three of those suppliers (Mobile Heaven, Inter Communications and AR) CSL undertook further transactions with those companies in which they supplied CSL with mobile phones in February 2006 and subsequently. Those transactions are included in the deals currently under appeal.

225. It was apparent from the evidence that the deals in February 2006 (and some in March 2006) with these suppliers (e.g. Deals 1, 2, 3, 4 and 11) were undertaken without any significant recent updating of the due diligence on these companies.

226. Mr Dad, in cross-examination, stated that he would have followed all the due diligence procedures referred to in HMRC Notice 726 (a point which, in our view, contradicted his claim in his witness statement not to have been advised by HMRC to carry out due diligence). There was no evidence that any earlier due diligence checks had been updated before CSL recommenced dealing with these three suppliers in February and March 2006. Moreover, given the warnings contained in HMRC's letters 23rd of January 2006 CSL could simply have refused to deal with these particular suppliers.

227. In our view, this indicated that Mr Dad took a cavalier attitude to the warnings received on 23 January 2006. He seems not to have cared whether he dealt with suppliers whose earlier transactions have been traced back to VAT losses and his claim that he had been "livid" when he received HMRC's warning letters of 23 January 2006 was contradicted by his failure to take appropriate action.

IMEI Numbers

228. There was a dispute concerning whether the Appellants had kept IMEI numbers.

229. In his first witness statement Mr Dad noted that it was alleged against him that he had not kept IMEI numbers and that he therefore had failed to take prudent precautions against involvement in carousel fraud. He stated as follows:

> "First, as far as I am aware, it has not been alleged that I have been involved in carousel fraud. Secondly, it is not clear whether the allegation that I did not "keep" such numbers is meant to mean that I have not made any such records or that I have not retain such records. I have carried out IMEI number checks since September 2006. I initially retained the IMEI numbers on paper, though not electronically. However, although I offered those records to HMRC, they would not look at them unless they were electronic.
>
> Paper records were made at the time of the inspection and I did not consider the duplication of transferring them to electronic media as a prudent use of my resources. I checked the IMEI listed on paper on a random basis against a sample quality of each batch of phones purchased. I would check the IMEI numbers against a net-checker, the address of which is www.numberingplans.com. Once this was completed and the IMEI

> numbers were confirmed as valid, I did not keep a check of these records as I was happy that my stock was as described on my paperwork. At the time of these transactions, I had not been directed to check and retain IMEI numbers. I was only required to record IMEI numbers after the periods which are the subject of this appeal and have of course done so."

230. This statement was not challenged in cross-examination.

231. In his first witness statement Mr Saunders recorded a visit which he and a colleague paid to CSL's offices on 13 June 2005. Mr Saunders's notebook contains the following entry:

> "Mr Dad… Stressed that whilst phones are not scanned, records of phones traded are recorded on sales and purchase orders, but IMEI numbers are not recorded."

232. Mr Saunders visited CSL's premises, with another colleague, on 22 July 2005. His notebook records:

> "I asked Mr Dad whether IMEI numbers were now being recorded and he said no. I asked how any returns could be verified to show that Crotek had supplied them and how he could be satisfied without IMEI numbers… That the goods were not stolen. Mr Dad could not be sure. Mr Dad will talk to the inspection team he uses to see if IMEI numbers can be made available."

233. In his first witness statement Mr Saunders states:

> "… [A]t the time of the transactions subject to this appeal neither CL nor CSL recorded IMEI numbers of mobile phones being traded."

234. This statement and the above extracts from Mr Saunders's notebooks were not challenged in cross-examination.

235. In answer to a question from the Tribunal, Mr Saunders stated that to the best of his knowledge the Appellants had not recorded IMEI numbers prior to the issuance of a notice of direction. The notice of direction was in September 2006. Mr Saunders explained that HMRC had been given no IMEI numbers for any of the deals at issue in these appeals.

236. In our view, on the basis of the evidence contained in Mr Saunders's notebooks, we consider that the Appellants did not record IMEI numbers of mobile phones before September 2006, despite being advised by Mr Saunders to do so.

237. As noted above, Mr Dad in his witness statement stated that he had "… carried out IMEI number checks since September 2006." This information was only recorded, however, after HMRC had directed the Appellants to record this information.

Conclusions on due diligence

238. It was plain to us that the due diligence comprised in the TSP reports in respect of the Appellants' customers referred to above was inadequate. In addition, many of the TSP reports were received after the Appellants had commenced dealing with the companies concerned. Moreover, insofar as the reports highlighted concerns, Mr Dad appeared not to have taken any account of the issues raised. Moreover, Mr Dad failed

to record IMEI numbers prior to September 2006 with the result that he could not be certain that the mobile telephones with which he was dealing had not been stolen or the subject of carousel fraud. We found Mr Dad's replies in cross-examination to be evasive. He consistently failed to engage with the questions he was asked.

Urban Spice Buyer Limited ("Urban")

239. CL bought mobile telephones worth £2,135,625 from Urban on 29 June 2006 in a transaction which is not subject to these appeals.

240. A TSP report on Urban commissioned by CSL was dated 12 July 2006, although a report on electoral roll information contained in the main report was dated 25 July 2006, indicating that the main report was not, in fact, finalised until that date. At any rate, it was clear that CL dealt with Urban before carrying out any external due diligence checks.

241. Mr Alan Ruler, an HMRC officer, gave evidence in relation to visits he paid to Urban.

242. Mr Ruler's first visit to Urban was on 24 April 2006 and he interviewed the director, Mr Rahman. Urban's business involved the introduction of restaurants to suppliers of food produce, restaurant furniture, china, cutlery etc. In return for introducing restaurants to suppliers, Urban would charge a "membership fee".

243. Urban's offer to sell telephones to a customer gave rise to an enquiry by the customer to HMRC's Redhill offices to check Urban's VAT registration. It was this enquiry that alerted HMRC to Urban's possible involvement in what Mr Ruler described as "MTIC activity" and prompted Mr Ruler's visit.

244. Mr Ruler discussed MTIC activity with Mr Rahman and, inter-alia, issued Notice 726 on Joint and Several liability. He discussed unsolicited approaches from traders wishing to do "large value deals", of which Mr Rahman said he had had none. Mr Ruler also explained that if Mr Rahman was asked to make a "third party" payment this should be taken as an indication that the VAT would not be paid to HMRC.

245. Mr Ruler also explained how VAT registrations could be hijacked and the function of HMRC's Redhill office, which was to be used to confirm whether or not customers and suppliers were VAT registered. Mr Rahman asked that his VAT registration number should be "blocked" at Redhill so that others could not verify it without his authority.

246. Mr Ruler was asked to visit Urban again in August 2006 because its VAT status had been verified by a "known" MTIC trader.

247. He explained that his restaurant supply business was struggling and that his wife had suggested that they should engage in some mobile phone deals. They therefore logged onto a mobile phone trading website (IPT) and found a customer: Crotek

Limited. He said he had two other customers: Adworks Limited and Ancillary Engineering Limited.

248. Mr Rahman was asked by Mr Ruler how he had found his supplier, Advertising South Limited. He said that "luckily" his customer, CL had introduced him to the supplier. Mr Ruler asked why his customer was effectively increasing the price he would have to pay by introducing a further business into the supply chain. Mr Rahman said he had never thought of that. Mr Ruler also asked if Mr Rahman thought that Urban had been introduced into the supply chain or "put there" for a specific reason – Mr Rahman did not respond.

249. Mr Ruler noted that Mr Rahman knew about the IPT website, IMEI numbers (distinctive mobile telephone serial numbers) and the due diligence checks that a normal business would carry out.

250. Mr Rahman confirmed that he had done some deals. When Mr Ruler asked how this could happen when part of the due diligence checks should have been to check the VAT status the business through Redhill, Mr Rahman replied that CL had told him "not to worry about that." Mr Rahman said that he had done 12 deals amounting to approximately £20 million sales in two days.

251. Mr Rahman told Mr Ruler that he had exchanged business details with both CL and Advertising South (VAT certificates, certificates of incorporation, directors' IDE and utility bills). Mr Rahman had also checked if the businesses were genuine through a credit reference company called Creditsafe.

252. Mr Rahman confirmed to Mr Ruler that he was paid by his customer before he had to pay for the goods from his supplier. He said that CL had asked for £10 million credit to which Mr Rahman had agreed. He, in turn, was given £10 million credit by Advertising South Limited. There were no written credit agreements and no security.

253. Mr Rahman confirmed that there was no insurance and there were no stock inspection reports. He also considered that the reservation of title provisions in the invoices did not apply to this kind of business. He was asked whether it appeared that CL appeared to be controlling the deals but he did not respond. He agreed that £20 million's worth of deals in two days appeared too good to be true.

254. Mr Rahman appeared to be shaken when Mr Ruler informed him that he would contact him again if his enquiries revealed a tax loss within his supply chain. Mr Rahman asked if his VAT number could continue to be "blocked" at Redhill. Mr Ruler informed him that the number could be blocked, but this action was meaningless if he did not make Redhill checks or took no notice of the results.

255. Finally, Mr Ruler asked whether or not Mr Rahman was thinking of entering into any further deals and Mr Rahman replied that he was not.

256. In his second witness statement, Mr Dad stated as follows:

> "Urban Spice Buyer This is… a matter of which I have only just been made aware and had no previous knowledge of although obviously the allegation against me is that I did have previous knowledge of this and I was fully aware of the situation. All I can say is that I vehemently deny that this is the case; I am and was totally unaware of Urban Spice. I did not set up any deal, nor tell them that I would make introductions or anything else. I am very concerned about the allegations made by the Respondents which I take personal offence to and it is my intention if at all possible to obtain and produce evidence in this regard. I have spoken to the Director of Urban Spice who denies the comments attributed to him and states they are a distortion of his words."

257. In cross-examination, Mr Ruler accepted that Mr Rahman's story was "fishy" and that he was suspicious about a trader who had told him that he was not going to have any dealings with MTIC activities and yet suddenly became involved in MTIC trading, finding a customer which then introduced him to a supplier.

258. Mr Dad was cross-examined about his statement and said, "I am and was totally unaware of Urban Spice." Mr Parroy suggested this was a clear and definitive statement and directed Mr Dad to the Statement of Truth at the end of his witness statement and to his signature. He asked Mr Dad

> "Q No doubt you would have looked carefully at this matter before you put your name to that statement?
>
> A The statement states what it states.
>
> Q Is it true?
>
> A It states what it states.
>
> Q Is it true?
>
> A At [sic] what I would have been aware of at the time.
>
> Q The allegation being made is effectively that you were setting up Urban Spice to use them as one of the buffers in the deals, isn't it?
>
> A That is not correct."

259. Mr Ruler's evidence in relation to what Mr Rahman said to him was hearsay. Whilst admissible, the real issue concerning hearsay evidence is the weight that should be attached to it by this Tribunal. In this connection, Mr Rahman did not appear before us to give evidence. It was not possible for Mr Kramer to test the evidence concerning Mr Rahman's statements in cross-examination. Certainly, it seemed to us that the statements attributed to Mr Rahman seemed strange. We consider that Mr Ruler was a truthful witness. Nonetheless, it was difficult for us to evaluate the truthfulness of Mr Rahman.

260. On the other hand, when questioned about his statement that he was unaware of Urban Spice, Mr Dad was plainly evasive. It was plain from the TSP report and the unchallenged fact that CL had entered into a transaction with Urban in June 2006 that the statement in Mr Dad's witness statement that he was ‘unaware of Urban Spice’ was incorrect.

261. On balance, because the story attributed to Mr Rahman seemed strange and unlikely, accepting (as we did) that Mr Ruler was a truthful witness, and because it was not possible for his story to be probed in cross-examination by the Appellants, it seemed to us fair to give very little weight to Mr Ruler's evidence. Moreover, in reaching this conclusion, we have borne in mind that we were given no explanation as to whether efforts have been made to call Mr Rahman as a witness so that we could have heard his evidence directly rather than second-hand.

262. On the other hand, Mr Dad was plainly evasive when his statement that he was unaware of Urban was challenged.

263. Our conclusion on this issue was that it was impossible to establish whether Mr Rahman's allegation that, in effect, CL had arranged the deal was, on the balance of probabilities, true. However we considered Mr Dad's responses in cross-examination further undermined his credibility.

Adworks.Com ("Adworks")

264. Mr Saunders gave evidence about a meeting with Mr Dad at CSL's premises on 13 June 2005. Mr Saunders questioned Mr Dad about one of his suppliers, Adworks. He pointed out to Mr Dad that payments to Adworks appeared to have been made after the goods in question had moved to Mr Dad's customer, Future Communications Limited ("Future").

265. Mr Saunders also noted (having been alerted by Claire Sharkey, an HMRC officer responsible for Adworks) that the paperwork for CSL invoice 3934 dated 27 April 2005 included a purchase order from Adworks addressed to its supplier, Apex UK Distribution Limited, asking for stock (mobile telephone handsets) to be delivered to CSL's customer, Future. The delivery note was dated 27 April 2005 and part payment for the goods in the sum of £600,780 was made by CSL on 10 May 2005. When Mr Saunders asked Mr Dad about this delivery request, Mr Dad saw nothing untoward in this. He also seemed unconcerned about the possibility that his supplier might cut out CSL in in future deals. Mr Dad replied that he was happy to trust Future based on the checks he had made.

266. Mr Saunders also asked Mr Dad whether he considered it reasonable that he had been able to get, and Adworks had been able to offer, credit of £4 million. Mr Dad said that he saw nothing out of the ordinary in being able to obtain a credit line from Adworks of £4 million.

267. Mr Dad, in his second witness statement on which he was not cross-examined, said he did not know precisely why Adworks agreed to give him such a large amount of credit. Mr Dad noted that he was a licensed Financial Services Adviser. He speculated that if he did not discharge an obligation to Adworks they could bankrupt him and he would be unable to work as a Financial Services Adviser. He considered that this gave Adworks some comfort and thought it unlikely that they would undertake further checks on him. He was not going to look a gift horse in the mouth. He said he was extremely concerned and felt the severity of the responsibility upon him in the event that things went wrong and he was unable to repay £4 million.

268. The due diligence checks on Adworks showed that it had only three issued £1 shares and no credit enquiries were made of this supplier. Information from the Companies Register stated that the last accounts of Adworks were made up to 30 November 2003 and showed that the company was dormant. The business classification of the company was "advertising."

269. Ms Sharkey noted that, following the 07/05 period, Adworks became involved in broker deals that were subject to extended verification resulting in denials of input tax in the sum of £8,869,705. Adworks then returned to buffer deals before going into liquidation. Ms Sharkey's evidence was not challenged.

270. In cross-examination, Mr Saunders accepted that it was normal for suppliers and customers to trust each other and undertake transactions without investigating matters. However, he considered that a credit line of £4 million was "a little beyond the normal trust."

271. The transactions with Adworks were not the subject of these appeals. However, the fact that CSL arranged for its supplier's supplier to deliver directly to CSL's customer is very strange. In our view, this indicated that this transaction was not a genuine transaction in the open market, leading to the conclusion that the transaction was contrived.

Goldex Services Limited ("Goldex"), Goldex International Limited ("GIP") and Mr Shafqat Dad

272. As explained above, Mr Shafqat Dad was Mr Dad's brother. He was originally a director of both Appellants, but resigned as a director of CSL in June 2005 and of CL in August 2005. Also, as noted above, it appears that Mr Shafqat Dad continued to hold shares in CSL until 29 August 2006.

273. HMRC alleged that Mr Shafqat Dad had previously been involved in dealing in mobile telephone handsets and that he had set up two businesses which moved away from their original stated business activity to become wholesalers of mobile telephones. HMRC invited us to draw parallels with the behaviour of the Appellants.

274. Mr Saunders gave evidence, which was unchallenged as to the essential facts (although Mr Dad's knowledge of these facts was disputed).

275. In July 1999 Mr Shafqat Dad applied to register a company, Cellular Consultants Limited ("Cellular") for VAT. In the application, its trade classification was described as "consultancy services to the cellular industry." Having been registered for VAT, Cellular commenced wholesale trading in mobile phones.

276. Mr Shafqat Dad applied to register a second company for VAT, Goldex, in November 2004. In the application for registration its business was described as follows:

> "We are a subsidiary of Goldex International Plc and will be providing legal, accounting, Treasury and admin services."

277. No trade was declared by Goldex until it commenced wholesale mobile phone trading in the September 2005 VAT period.

278. By a decision letter dated 13 March 2009, HMRC denied Goldex's claim for repayment of input tax. Goldex was dissolved on 5 May 2009, but was, we understand, subsequently restored to the Companies Register in order to litigate its appeal. A further input tax denial letter was dated 30 March 2009.

279. In addition to Goldex, Mr Shafqat Dad was also a director of Goldex International Plc ("GIP"). GIP was also involved in the wholesaling of mobile phones. In April and May 2007 HMRC denied input tax in relation to repayment claims submitted by GIP. These decisions were subsequently appealed.

280. The evidence of Mr Martin, the HMRC officer allocated responsibility for GIP, was that there were similarities between the deal chains involving the Appellants and those involving Goldex and GIP. The evidence of Mr Martin was not challenged.

281. In respect of CSL's Deal 19 (23 March 2006), CSL bought from Datakey and sold to URTB. The full deal chain was as follows: Stella sold to Deepend which sold to Bluewire which sold to Datakey which sold to CSL which sold to URTB. On 22 March 2006, Goldex was involved in an identical deal chain, as follows: Stella sold to Deepend which sold to Bluewire which sold to Datakey which sold to Goldex which sold to URTB.

282. Secondly, in CSL's Deal 8 (7 April 2006) the deal chain was as follows: Bulfinch sold to Wireless Warehouse which sold to AE Resources which sold to AR Communications which sold to CSL which sold to URTB. GIP's deal chain (5 May 2006) was identical, save that GIP occupied CSL's position in the deal chain.

283. Finally, CSL's Deal 27 (18 May 2006) involved XS Enterprise Systems which sold to Deepend, which sold to IT Players which sold to Mobile Heaven which sold to CSL which sold to URTB. GIP's transaction chain (15 May 2006) was identical save that GIP took the place of CSL.

284. In each transaction chain the immediate supplier of CSL, Goldex and GIP made a mark-up of £.50.

285. In his second witness statement Mr Dad said:

> "There is a specific allegation with regards the fact that my brother formed this company and then removed himself from the company. I actually find it difficult to respond to this as I am not aware of all the actions of my brother. I simply, as I have already stated, purchased this company from my brother who had no actual involvement in the business."

286. Our conclusion on this evidence was that it was clear that Goldex and GIP were operating in conjunction with CSL. We did not find Mr Dad's statement that he was unaware of his brother's activities to be credible. It was simply too much of a coincidence that the deal chains, which were close together in time, should be

identical. We regard this as further evidence that the Appellants' transactions were contrived.

FCIB evidence

Mr Stone's evidence relating to FCIB

287. Mr Stone, a senior HMRC officer with responsibility for dealing with MTIC fraud, gave background evidence in relation to MTIC fraud. In the course of his evidence he commented on offshore banking arrangements with FCIB.

288. In his witness statement Mr Stone noted that between 2005 and 2006 many EU suppliers, defaulting traders, buffers, brokers, contra brokers, and overseas customers in the computer and mobile phone sector whose transactions were connected with MTIC fraud opened offshore bank accounts. He noted that some traders claimed that this was because UK banks were closing their accounts. This was first reported in a mobile phone trade publication called *Mobile News* on 21 October 2005.

289. The most popular offshore bank was FCIB. On 5 September 2006, the Dutch and local authorities visited FCIB as part of an investigation into alleged money-laundering by the bank in relation to alleged VAT fraud by clients of the bank.

290. In a press release dated 11 October 2006 by the banking authority in the Netherlands Antilles, it was announced that as a result of several criminal investigations in relation to alleged VAT fraud involving a large number of customers, and subsequent attachments on funds, FCIB was no longer able to process payments. A number of other banks terminated their relationships with FCIB and the banking authority in the Netherlands Antilles decided to revoke FCIB's banking licence with effect from 9 October 2006.

291. In cross-examination, Mr Stone was asked whether an uninitiated party joining the industry could assume that FCIB was an entirely legitimate, substantial and significant financial institution. He replied: "FCIB is a registered bank, yes."

292. Mr Stone also accepted that there was a significant concern within the mobile phone industry that traders' bank accounts might be closed with extremely short notice, leaving them without banking facilities.

Opening the Appellants' FCIB accounts

293. On a visit to CSL on 17 May 2005 Mr Saunders asked Mr Dad what bank accounts CSL held. Mr Dad said that CSL held two bank accounts: the first account was with Bank of Scotland and the second account was with FCIB. Mr Saunders asked Mr Dad why it was necessary to have an account with a bank in the Netherlands Antilles. Mr Dad replied that FCIB had been advertised on the IPT website as a fast payment processor.

294. In his second witness statement dated 11 March 2009 Mr Dad stated:

> "… [I]t was impossible and remains extremely difficult for traders to open accounts with any bank which I understand from having read

> some websites and spoken to people has been caused by the actions of the Respondents in this appeal.
>
> Therefore the only bank that could provide services and was willing to provide services was FCIB whom I understood to be a well-regarded and substantive Dutch bank. It further had the infrastructure to provide very efficient service for all customers which is why I banked with them.
>
> I further understand that the problems that have arisen with FCIB have also been caused by the direct actions of the Respondents and although the Respondents directly or indirectly have made allegations for some three years against FCIB nothing has been proven to date.
>
> To explain we used to have banking with the Bank of Scotland a mainland UK regulated bank. Unfortunately our accountants were concerned that our accounts would be closed I believe through the direct and/or indirect actions of HMRC on the basis of information that I have been told both by the bank and other third parties none of whom were prepared to make a statement about this. The actions of HMRC were to close down accounts as that was a way and manner of using the Respondents' term obstructing and interrupting "the fraud". I in line with numerous other traders were [sic] left unable to open bank accounts other than with an overseas bank. I consider FCIB can be fairly described as less favourable an option compared to a UK bank however we were denied the option of operating a UK account by the actions of HMRC."

295. There was, however, no suggestion at the meeting on 17 May 2005 between Mr Saunders and Mr Dad that the FCIB account had been opened because HMRC were threatening or attempting to close CSL's Bank of Scotland account.

296. In addition, Mr Dad confirmed in cross-examination that he had opened an account for CL with Bank of Scotland (Reading branch) on or around 1 September 2005. Mr Dad also confirmed that CSL had an account with bank of Scotland in February 2005 when it undertook its first transaction in mobile telephones. Mr Dad also confirmed that the application for an FCIB account was made on 17 February 2005. Mr Dad also confirmed that the CSL account with the Bank of Scotland was closed in December 2005. He recalled receiving a letter from Bank of Scotland informing him that banking facilities would be withdrawn within 30 days.

297. Earlier, in cross-examination, Mr Dad confirmed that CSL's application for an account with FCIB had preceded the first deal by approximately 8 days at which time CSL had banking facilities in place with Bank of Scotland. He said that a letter from Bank of Scotland stating that CSL's banking facilities were going to be withdrawn was received "soon thereafter." Mr Parroy asked Mr Dad:

> "Q Had the Bank of Scotland told you, before you made this application [the application to open an FCIB account], that their banking facilities were to be withdrawn?
>
> A The letter would have been received soon thereafter [sic] the first few transactions."

298. Subsequently, Mr Dad said that he could not recall, after six years, the precise sequence of events.

299. As regards advice from his accountants expressing concern that the Appellants' accounts with UK banks would be closed, Mr Dad was unable to produce a copy of any such advice and could not remember whether it was written or an oral discussion.

300. We did not consider Mr Dad's claim, that he had opened an FCIB account because of concern expressed by his accountants that his existing accounts would be closed, to be credible. Apart from his statement, Mr Dad produced no evidence to this effect. CSL's Bank of Scotland account remained open until early December 2005. The application to open an FCIB account was made in February 2005. Mr Dad's comments made to Mr Saunders on 17 May 2005 contained no suggestion that the FCIB account had been opened to safeguard against the closure of the Bank of Scotland account.

Objection to the admission of evidence relating to the FCIB Paris server

301. Mr Saunders in his second witness statement gave evidence in relation to information derived from FCIB. The information contained in that statement was derived from what was called the Dutch server containing a database relating to FCIB.

302. At the PTR on 11 April 2011 the Tribunal was asked by HMRC to consider the status and future direction of the appeals. This was caused by the difficulties HMRC were experiencing in contacting the Appellants' legal representatives. On 24 December 2011 HMRC had discovered in the course of another appeal that Mr Kramer, who is representing the Appellants before the Tribunal, was leaving his (then) firm. On 3 February 2011 HMRC wrote to Mr Kramer's previous firm enclosing an application to update HMRC's witness statements. Mr Kramer's previous firm advised HMRC that they were no longer instructed and suggested that HMRC should contact Mr Kramer's new firm. However, the new firm also indicated that they were not instructed to act for the Appellants.

303. On 14 February 2011, HMRC wrote to the Appellants advising them that HMRC was applying to the Tribunal for a Directions hearing to consider the status and direction of the appeals.

304. On the same date HMRC applied to the Tribunal requesting an urgent Directions hearing due to the Appellants' lack of representation. The Tribunal notified the Appellants of the date of the Directions hearing.

305. The Appellants did not appear and were not represented at the Directions hearing on 11 April 2011. In the circumstances, HMRC stood over until the main hearing their application to admit the third witness statement of Mr Saunders and the witness statement of David Young (together with exhibits) in relation to the Appellants' transactions with FCIB. These witness statements were based on new information available from what was called the Paris server in relation to FCIB and which had become available more recently than the information from the Dutch server.

306. On 2 May 2011, the Appellants' current solicitors notified the Tribunal that they were instructed to act on behalf of the Appellants. This letter stated that it included an application in relation to the appeal, but through a clerical error the correct application was not enclosed.

307. At the hearing of these appeals HMRC applied to admit the third witness statement of Mr Saunders and the witness statement of Mr Young. Mr Kramer, on behalf of the Appellants objected. The witness statements and exhibits comprised one lever arch file, although part of that file comprised formal legal documentation (e.g. incorporation documents of companies) rather than printouts of records from FCIB accounts.

308. At the outset of the hearing, it was agreed that HMRC would proceed to open their case and that Mr Saunders would give evidence in chief in relation to the information derived from the Dutch server and that Mr Kramer would then be given time to absorb the FCIB material. One and a half days were set aside to allow Mr Kramer to study the material (it appears Mr Kramer mislaid the lever arch file containing the new evidence with which he had previously been provided, thus preventing him from studying the material until that time).

309. After studying the new material, Mr Kramer maintained his objection to its admission.

310. Mr Parroy argued that the new evidence was both relevant and probative. It had recently become available. Until December 2010 (or the late autumn of 2010) the French authorities had not allowed access to the Paris server evidence for use in civil cases. The French authorities had previously limited access to the Paris server material to use in criminal cases. Mr Saunders gave evidence to the effect that he was not allowed to access the information on the Paris server until he had been trained in its use. He received that training on 1 February 2011.

311. Mr Parroy submitted that the money movements contained in the new evidence would be material which the Appellants would have to argue Mr Dad knew nothing about. If not, they were money movements in which he was directly involved, and the material fell within his personal knowledge.

312. Mr Parroy submitted that the Paris server material was needed to correct and complete information derived from the Dutch server. We had heard evidence from Mr Saunders that the information on the Paris server was more reliable than that contained on the Dutch server.

313. Mr Kramer drew attention to a statement in Mr Saunders's witness statement to the effect that the Paris server was made available to HMRC on 27 September 2010. Therefore, HMRC had had access to the Paris server for approximately 8 months. In considering the balance of prejudice, the Appellants would not be able to test the raw data and would not have time to investigate the evidence without an adjournment. Mr Kramer therefore requested that the application to admit the evidence should be denied.

314. Mr Parroy insisted that the information on the Paris server was not available to be used until December 2010 because of the need to test the integrity of the process. As a result, the data wasn't actually fully available until the start of 2011. Also, once it became known that the Paris server information was available, HMRC were under a duty to examine the Paris server material to ensure that the material derived from the Dutch server was correct and to make available the information from the Paris server. It would not be possible, without major technological problems and without disclosing information which was not relevant to these Appellants, to provide an "image" of the Paris server. The material bank statements contained in the exhibits was the raw material contained in the FCIB file. The various companies concerned in the new evidence were, in fact, not new and were referred to in evidence that had already been admitted.

315. We decided that the new material relating to the Paris server should be admitted. The material was plainly relevant and material. We considered that there were valid reasons for the late production of the evidence and accepted Mr Parroy's submissions in this respect. We agreed with Mr Parroy's submission that the prejudice to the Appellants was limited. We also denied Mr Kramer's application for a further adjournment to consider the evidence.

316. In short, Mr Saunders's third witness statement relating to the Paris server made certain relatively minor corrections to the information contained on the Dutch server. In addition, however, the new evidence disclosed loans to CSL from a sub- account of a company called Padani Developments ("Padani") which we set out later in this decision.

The Dutch server information

317. Based on the information derived from the Dutch server, Mr Saunders's evidence was based on a sample of the deals in respect of this appeal. The samples included at least one deal for each appealed VAT period and at least one sale to each EU customer as well as all defaulters. The deals sampled were (in chronological order) as follows: Deals 21, 1, 11, 3, 16 (and 17), 18, 20, 30, 32, 10, 22, and 28 and CL 4.

318. Mr Saunders commenced his analysis from the account of either CSL or CL, tracing the receipt of the money where possible from the EU customer of either CSL or CL and then tracing along the deal chain to their suppliers in the UK. Mr Saunders also traced the payment backwards from the EU customer in order to identify money movements beyond the UK deal chain. Mr Saunders compared the amounts appearing in the trading accounts of the Appellants with the date and value of the invoices identified in the deal chain spread sheets. He then traced the monies paid and received by CSL and CL through the recipient and the payer of the funds. Where there were no known payments or invoices, he had had to use his judgement to identify the relevant onward payment. It was not always possible to identify sums of money which exactly matched those shown on the invoices.

319. Essentially, the analysis performed by Mr Saunders showed payments moving from the Appellants' EU customers to the Appellants. The Appellants paid their

suppliers and the payment moved along the deal chain until, significantly, the defaulting trader paid a company called Elvissa International Holdings ("Elvissa"). Elvissa received a payment from the defaulting trader in every deal that Mr Saunders examined. In a significant number of deals it was possible to trace payment from Elvissa to a company called Amex FHU ("Amex"). Amex, in a number of deals, provided the funds for the Appellants' EU customer to make their purchase. In a number of cases funds were received by Elvissa from the defaulting trader and payments were made by Amex to the Appellants' customer but it was not possible to trace with certainty the payment from Elvissa to Amex. It appeared that Elvissa was the financier of the deal chains.

320. Mr Saunders exhibited information received from the Polish authorities in relation to Amex. This information stated:

> "Company is not existing [sic] – Mr R Jarkiewicz is missing trader in Carousel fraud. At present he is hijacker – he use [sic] VAT numbers which belongs to legal taxpayers."

321. Further information received from the Polish authorities stated: is

> "Mr Robert Jarkiewicz – the owner of the AMEX FHU was deregistered from VIES on the 30/09/2005 until now he has not renewed the registration. A warrant is out for the owner Mr Robert Jarkiewicz's arrest for swindling bank credits and for economic crimes. As the Polish Prosecutor informed us he is staying at [sic] the UK territory but we do not [know] exactly where."

322. Elvissa is registered in the British Virgin Islands with a mailing address in Israel.

323. The forms opening CSL's FCIB account show that approval for the opening of the account was given on 3 March 2005. The secretary and quoted director was Mr Dad. Mr Shafqat Dad and Mr Safdar Dad were stated to be the beneficial owners.

324. The forms opening CL's FCIB account show that approval for the account was given on 12 April 2006. The signatory was given as Mr Dad. The directors were stated to be Mr Dad and Frieda Dad, who were also said to be the beneficial owners.

Information from the Paris server

325. Besides correcting some aspects of the payment chains in respect of information available from the Dutch server, Mr Saunders's evidence in relation to information from the Paris server drew attention to a loan of £100,000 and a further loan of £17,500 that CSL received from a sub-account with FCIB of an entity called Padani. Mr Saunders had previously been unaware of the existence of these loans and had seen no documentation in respect of them.

326. Information received by HMRC from the Spanish authorities stated that Padani, a company incorporated in Spain, was a missing trader.

327. The FCIB account number for Padani was 202082 with subaccounts 202082 – 02, designated as Amber Communications Management Limited ("Amber"), and 202082 – 03, designated Seaside Mediteranea Limited ("Seaside"). The signatory for those accounts was Maria Teresa Jimenez Suarez.

328. The loan to CSL was paid from the account designated Seaside and was made on 6 December 2005. A further loan to CSL in the amount of £17,500 was made from the same account on 7 December 2005. The funds in that account were provided by a company called Juleo Limited ("Juleo"). Juleo's FCIB account number was 201744 and the signatory was a Michael Touitou, a French passport holder resident in Israel. Michael Touitou was also the signatory of Elvissa and its sub-account designated as Helvissa International Holdings Limited. Elvissa, as noted above, was the recipient of funds from the defaulting traders in all the deals sampled by Mr Saunders. Although the account was opened in the name of Elvissa, the sub-account was designated Helvissa (although Helvissa was the same company as Elvissa).

329. Although a different passport and mother's maiden name were given for Michael Touitou in respect of Juleo and Elvissa in FCIB's records, the date of birth is the same and they shared the same notary. The signatures of Michael Touitou signing for Juleo and for Elvissa appeared very similar.

330. A search by HMRC revealed a company in the name of Seaside Mediterranea SL, of which the director was Michael Touitou.

331. Mr Saunders identified the UK incorporated company called Amber Communications Management Limited. This company had been denied input tax by HMRC on the grounds of knowledge/means of knowledge of fraud and had appealed HMRC's decision.

Mr Young's evidence – Paris server

332. Mr David Young was an intelligence analyst with HMRC. When asked to do so by an HMRC Department, he would analyse information to establish facts from that data. He had been trained to use the FCIB Paris server and confirmed that he had received this training in May 2010, at which time the information on the Paris server was available to be used in criminal proceedings.

333. Mr Young received e-mails from Mr Saunders on 16 March and 22 March 2011 containing deal sheets for Deals 16 and 17, Deal 18, Deal 22 and Deal CL 4.

334. Mr Young was asked to compare the deal sheets with the information recently acquired from the Paris server. The comparison was used to produce a payment chain relating to the transactions shown on the deal sheets. Each payment chain was displayed as a chart showing the payment chain and the signatory or all signatories associated to those accounts.

335. In compiling his analysis, Mr Young used proprietary HMRC software called iBridge. This software carried out searches of the FCIB Paris data to identify accounts and payments that matched details in the deal sheets.

336. Mr Young created four charts illustrating the movement of money and mobile telephones in the above deal chains.

337. Three of those charts showed money moving from Elvissa's sub-account ("Helvissa") to Amex and from Amex to CSL's EU customer. CSL paid the money to its supplier and the money then proceeded up the UK deal chain as far as the defaulter. The defaulting trader then transferred the money to the Helvissa sub-account.

338. The fourth chart showed that the money transfers began chronologically with CSL (Deal 18) on the 22 March 2006 nineteen hours before it received the funds from Balsim on 23 March 2006. In that period the funds moved from company to company through the links of the UK deal chain, passing from the defaulting trader, Stella, to the Helvissa sub-account which then paid Amex. Amex paid Balsim and nineteen hours after the initial transfer from CSL, Balsim paid CSL and the money had moved in a complete circuit.

339. A feature of the Paris server information was that Mr Young was able to identify the time of each payment. In Deal CL 4 £1,121,850 is paid out of the Helvissa sub-account at 15.30 on 24 April 2006 and £1,229,343.75 is paid back to the same sub-account at 16.45 on the same day. The funds passed through seven other FCIB bank accounts in that time.

340. In addition, Mr Young looked for all IP addresses used by signatories to the accounts around the time the payments were made, where these were available. This provided the dates and times that an FCIB account signatory logged in. It also provided the IP address they were using when they logged in. Mr Young then identified which IP address was being used at the time of the payment or within 3 min prior to the payment being made (to account for the FCIB server refresh). The FCIB data did not hold details of IP address logins prior to 29 April 2006.

341. Mr Young explained that the IP address was effectively the gateway or router that someone had used to access the Internet.

342. In Deal 7 it was apparent that URTB (CSL's customer) was using the same IP account as Amex and Elvissa. In other words, those three companies were using the same IP address to access FCIB online accounts at the time they were making their payments.

Cross-examination of Mr Saunders and Mr Young on FCIB evidence

343. Mr Kramer cross-examined Mr Saunders, asking him whether he could vouch for the integrity of the information that came from the Dutch server. Mr Saunders replied that he had no direct knowledge as to the method by which the information was seized, stored, packaged and interrogated.

344. Mr Kramer suggested to Mr Saunders that moving money around a payment chain was a difficult logistical exercise to have been used in a fraud. Mr Saunders did not agree that the payment chain was particularly complex.

345. In cross-examination, Mr Young noted that from the information available on the Paris server it was not possible to ascertain the purpose of any payment.

346. Mr Kramer questioned Mr Young about a payment of 2,080,000 from Helvissa to Amex in relation to Deal 18. He suggested that it might have nothing to do with the other money transfers in the payment chain because it was of an entirely different amount. Mr Young acknowledged that the payment was of a different amount but explained that it was shown on the chart because the analytical software he used could see the account balances before and after the payments were made. The software could establish that in order for Amex to make the next payment in the chain to Balsim, Amex had to have received the funds from Helvissa. There were not enough funds in the Amex account to have made the next payment without the incoming funds from Helvissa.

347. In response to Mr Kramer's question about iBridge, Mr Young confirmed that the charts he had produced using it were effectively taken straight from the Paris server data. iBridge automatically converted the information into a chart.

Cross-examination of Mr Dad on FCIB evidence

348. Mr Dad denied any knowledge of the loan of £100,000 on 6 December 2005 and of £17,500 on 7 December 2005 from Padani's FCIB sub-account in the name of Seaside. He stated that he had not seen the loan entries before. He was asked where the £100,000 loan came from and replied that he did not know. He was asked:

> "Q I take it you noticed? You couldn't fail to miss £100,000 coming into your bank account, could you?
>
> A However, I believe this is the server's printout, it is not, as opposed to the banking information I had available when I was operating the account? And it is our main account so…
>
> Q £100,000 to the penny comes into the account. You couldn't fail to notice, could you, the arrival of £100,000?
>
> A No, you could not.
>
> Q And, needless to say, like any careful businessmen, Mr Dad, you would check your bank statements and the transactions in your bank extremely carefully?
>
> A Yes
>
> Q You didn't have an overdraft facility with FCIB, did you?
>
> A No
>
> Q So you need to know the balances in your account among other things to know if you can afford to do a deal, can you do this trade… can you pay the rent, all the basics. Where did the £100,000 come from?
>
> A Like I said, I do not know.
>
> Q It's not just the £100,000, is it? Because if we go back to page 253, 7 December 05, £17,500 comes in. Where does it come from?

A I don't know.

349. When Mr Parroy pointed out that £117,500 had come into CSL's FCIB account from Seaside, Mr Dad said: "This information does not look correct." Later, Mr Parroy asked Mr Dad:

> "Q So you are getting paid money which has originated with a man whose account has put £100,000 into your account. Now you are not trying to tell us that that's mere coincidence, are you?
>
> A Like I said, this is the first this was brought to my attention. I had no loans from any other business. Our accounts were fully audited. Bank statements were provided to Nigel [Mr Saunders] on a monthly basis with printouts of all large transactions. This information is just fully disputed.
>
> Q If it is true, and you knew about it, it means that you have had a loan from somebody who is absolutely at the heart of this fraud, doesn't it?
>
> A Like I said, this is the first it was brought to my attention obviously at the start of this Tribunal.
>
> Q But if it is true and you knew about it what I said is wholly correct, isn't it?
>
> A It is not true and I didn't know about it."

350. In our view, Mr Dad's replies were unconvincing. He was, in our view, plainly uncomfortable whilst he was being questioned about the loans from the Padani sub-account and we did not consider his evidence to be credible.

Our conclusions on FCIB evidence

351. As already discussed, we did not consider Mr Dad's evidence that he had opened an FCIB account because he was concerned that his existing UK bank accounts would be closed was credible.

352. The evidence concerning the Dutch server clearly indicated that the transaction chains were being financed by Elvissa (via Amex) and we considered it more probable than not that the money in the transaction chain flowed round in a circle. There was, however, no indication from the Dutch server evidence that the Appellants were aware of this circular flow of funds or of the existence of Elvissa or Amex. The evidence did, in our view, establish that the deal chains were contrived.

353. The Paris server evidence changed the picture in respect of the Appellants' knowledge. The two loans to CSL's FCIB account of £100,000 and £17,500 from the Padani sub-account in the name of Seaside, plainly connected CSL to Mr Michael Touitou and to Elvissa. Mr Young's evidence made the circular flow of funds even clearer and the use of the same IP addresses supported the conclusion that the transaction chain was contrived.

354. The loans from the Padani sub-account to CSL connected CSL (and Mr Dad), in Mr Parroy's words, to those who were at the heart of this fraud.

Submissions of the parties

Submissions of HMRC

355. Mr Parroy's primary submission was that the evidence clearly established that, through the knowledge of Mr Dad, the Appellants knew that their transactions were connected with the fraudulent evasion of VAT. His secondary submission was that the Appellants ought to have known that their transactions were connected to the fraudulent evasion of VAT.

356. In summary, Mr Parroy submitted in support of his primary submission:

(a) the Appellants were set up under false trade categories and then traded in mobile phones;

(b) the VAT applications for the Appellants were misleading;

(c) Mr Dad was aware of fraud in the mobile phone industry;

(d) Mr Dad's brother, Shafqat Dad, participated in the trading of the Appellants and coordinated this trading with Goldex and GIP;

(e) Mr Dad lied about his knowledge of the original purpose of CSL;

(f) Mr Dad's account of why an account with FCIB was established was untrue;

(g) the trading patterns of the companies indicated that the deals were fraudulent:

– all deals led back to defaulting traders

– buffer deals ended up with defaulting traders

– the Appellants and Goldex and GIP dealt with the same suppliers and customers frequently in identical chains

– the defaulting traders were used chronologically

– the profit margins on the buffer deals were consistent

– profits from broking deals always substantially exceeded profits made by buffers. The major profits from these broker deals went to the Appellants.

– The volume of trade of the Appellants increased rapidly following the *Bond House* decision

– the Appellants failed to obtain proper due diligence on suppliers/customers prior to dealing and when due diligence was obtained scant regard as was paid to it

– failure to specify in deal documentation the precise nature of mobile telephones being traded (i.e. language, model software, keypad etc)

– all the deals where Mr Saunders traced the flow of funds involved Amex. The person operating this company was sought by the Polish authorities for fraud and operated fraudulently

– all deals involved European stock with two pin plugs. No credible explanation was given as to why such goods would ever have been imported into the UK in huge numbers

– the Appellants failed to obtain IMEI numbers

– none of the Appellants' suppliers was either a manufacturer or an authorised distributor and the deal chains never led to a consumer

– arbitrage was unlikely according to Mr Fletcher's evidence, particularly with Nokia handsets

– if the Appellants were "innocent dupes" inserted into fraudulent chains, how were they manoeuvred so that they always bought from and sold to those participating in the fraud?

(h) The Appellants were connected to those involved in the control of the fraud as indicated in

– Deal 25: payment by CSL of the precise sum due by Datakey to its own supplier Bluewire

– Loans from the Padani sub-account of £117,500 to CSL was derived from Michael Touitou who played a prominent role in financing the fraud

– Urban Spice Buyer: the evidence of Mr Ruler showed that the Appellants were actively promoting and organising fraudulent dealing. Mr Dad denied being aware of Urban but had obtained a TSP due diligence report on the company

(i) the Appellants continued to trade with companies whom they knew (HMRC warning letters of 23 January 2006) had supplied goods in transaction chains tainted by fraud

(j) Mr Dad was evasive and untruthful on important issues.

357. In support of his secondary submission that the Appellants ought to have been aware that their transactions were connected with fraudulent evasion of VAT, Mr Parroy's submissions, in addition to those listed above, can be summarised as follows:

(a) there was only a very limited grey market (the evidence of Mr Fletcher)

(b) market research showed that the available market was smaller than the alleged sales by the Appellants (the evidence of Mr Fletcher)

(c) there was no basis for the level of profits achieved by the Appellants

– the Appellants achieve huge turnovers shortly after being established

– no value was added by the Appellants

– the major percentage of profits were received by the Appellants

– profits were consistently earned without the company sustaining losses or being left with unsold stock

– profits were earned despite the lack of experience of Mr Dad in mobile phone dealing

> – the Appellants earned profits despite the lack of capital available to them
>
> – the Appellants were apparently able to obtain massive credit without formal credit agreements or assets/trading history to support the applications
>
> – the Appellants have been unable to point to any transactions which were not tainted by fraud

358. In response to Mr Kramer's opening submission that HMRC should have prevented or have done more to prevent the Appellants from being parties to fraudulent deal chains, Mr Parroy submitted that HMRC were constrained in what they could say about other traders because of statutory taxpayer confidentiality. Moreover, the question with whom a company trades was the responsibility of that company. Mr Parroy cited the judgment of Floyd J in *Mobilx Limited v HMRC* [2009] EWHC 133 (Ch) at paragraph 87 where the learned judge said:

> "It is true, as the Tribunal accepted, that the directors took comfort from the actions of HMRC. But the company has to exercise independent judgment, not delegate its judgment to HMRC. I agree entirely with the Tribunal when it said that "there must come a time when a trader, told that every one of his purchases followed a tainted chain, is compelled to recognise that without a significant change in his trading methods every one of his future purchases is more likely than not also to follow a tainted chain". The trader is not entitled, when that point has been reached, to wait the HMRC to tell him to cease to trade. Moreover, as the Notice [726] explained, HMRC's advice is not intended to create a shield for fraud."

359. Moreover, the Appellants chose to remain in the business of wholesaling mobile phones knowing that the sector was rife with fraud. The Appellants did not take adequate steps to protect themselves from fraudulent dealings and were regularly warned by HMRC of the dangers inherent in the trade that they pursued.

360. Mr Parroy drew particular attention to the approach of Christopher Clarke J (approved by Moses LJ in the Court of Appeal in *Mobilx* [2010] EWCA Civ 517) in *Red 12 Trading Limited v HMRC* [2009] EWHC 2563 (Ch) at paragraph 110:

:

> “Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.

> To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them."

361. Mr Parroy submitted that these words of Christopher Clarke J were particularly apposite in the present case.

362. Accordingly, Mr Parroy submitted that the Appellants either knew or ought to have known that their transactions which formed the subject of these appeals were connected with a fraudulent evasion of VAT and that, therefore, the appeals should be dismissed.

Submissions for the Appellants

363. Mr Kramer submitted that the appeals had to be determined by reference to the Appellants' knowledge at the time they entered into the relevant transactions. Mr Kramer emphasised that the Appellants had limited resources with which to conduct investigations. They voluntarily produced the information and documents that HMRC requested. By contrast, however, HMRC had much greater resources with which to conduct investigations.

364. Mr Kramer submitted that HMRC were under an obligation to undertake adequate investigations and to be certain of the information in relation to matters placed before the Tribunal. HMRC had greater investigative tools available than the taxpayer. Mr Kramer cited *Calltell Telecom Limited Opto Telelinks (Europe) Limited v HMRC* 20266 at paragraphs 11 – 17. At paragraphs 14 – 16 the Tribunal (Colin Bishopp (Chairman) and Cyril Shaw FCA) made the following observations:

> "The adverse effects on a business of the withholding of substantial amounts of input tax credit are obvious, and a decision to withhold should, correspondingly, be based on proper enquiry and sound evidence rather than on supposition. So much, we imagine, is uncontroversial, but there are nevertheless limits to the extent of the burden which can

be imposed on the Commissioners, on which some guidance was offered by Lightman J in *R (UK Tradecorp Ltd) v Customs and Excise Commissioners* [2005] STC 138 when, at [18], he said:

"The commissioners are under a duty to conduct a reasonable and proportionate investigation into the validity of claims for a refund and repayment and a duty to act proportionately both in respect of the investigation and in dealing with the taxable person's claims generally. See *R (on the application of Deluni Mobile Ltd) v Customs and Excise Comrs* [2004] EWHC 1030 (Admin). The duty to investigate is applicable both to the claim to the refund and repayment and to the question whether there is a right to set-off (or indeed a claim for a further payment from the taxable person). The duty embraces an obligation to keep all investigations under review. The commissioners are entitled to take a reasonable time to investigate claims prior to authorising deductions and repayments and what is a reasonable time within which to complete an investigation must depend on the particular facts: *Strangewood* [1987] STC 502 at 505. The availability and proper exercise of the commissioners' powers of investigation are essential to maintain the fiscal neutrality of VAT and prevent refunds being made to parties not entitled to them. The postponement of repayment of input tax pending the outcome of the investigation is, as a matter of principle and subject to questions of proportionality, entirely compatible with the Sixth Directive. Whilst the burden of proof is upon the taxable person to establish that the investigation of his unadmitted and unadjudicated claim and the failure to make a part or interim payment is unreasonable or disproportionate, the burden is on the commissioners to justify non-payment of it once the claim is admitted or established and the period of investigation of any cross-claim."

The question whether the Commissioners' investigations were adequate is, we think, more properly dealt with in the context of the evidence adduced at the hearing and the conclusions which can be legitimately drawn from it, rather than by way of general observations, but that question does have some additional bearing on the extent of the duty of disclosure of documents.

It is inevitable that, unless traders in the Appellants' position are conspirators in a fraud, they will not have access to the documents and information which the Commissioners are in a position to secure, and elementary natural justice demands that the Commissioners should be open and generous in determining the scope of the disclosure of documents which they offer, regardless of any direction by the tribunal. Certainly all those documents on which they relied, directly or indirectly, in reaching a decision to withhold a claimed input tax credit should be volunteered. It is in our view clear that it is not sufficient in a case of this kind for them to limit disclosure to the bare minimum required by rule 20(1) of the Value Added Tax Tribunals Rules 1986 (SI 1986/590) as amended, namely to those documents they wish to produce at the hearing. Commonly, the tribunal will be asked to make a direction in accordance with rule 20(3) for additional, specific, disclosure, but an appellant seeking such a direction will, often, be hampered in that he will not know the nature of the documents which are available and which he should endeavour to have included in the direction."

365. Mr Kramer noted that a number of HMRC witnesses have been trained in how to give evidence. He described them as "professional witnesses". He contrasted this with Mr Dad, who had no experience of giving evidence before a Tribunal. He explained that Mr Dad's evidence was, in his words, confused and stressed.

366. As regards the FCIB evidence, Mr Kramer drew attention to the evidence of Mr Stone who accepted that, to the external world, FCIB was a legitimate bank. Mr Kramer also submitted that the FCIB evidence in respect of the Paris server, according to Mr Young, had become available to HMRC in the middle of 2010 and not more recently as Mr Parroy had submitted. Mr Kramer noted, however, that HMRC were only given permission in September 2010 to allow FCIB evidence to be used in civil cases. Mr Kramer submitted that no weight should be given to the Paris server evidence and that its late introduction should be taken as an indication of the manner in which HMRC had dealt with the provision of information and placing of evidence before the Tribunal.

367. Mr Kramer drew attention to the fact that neither Mr Saunders nor Mr Young could vouch for the integrity of the FCIB Paris server data. Mr Kramer submitted that the position was that the Tribunal had evidence placed before it in respect of which it did not know the source and which had not been available for testing.

368. Referring to the evidence of Mr Saunders and Mr Young, Mr Kramer noted that although the diagrams attached to their evidence indicated that money went round in a circle it did not indicate the money coming out of the circle. The Tribunal had not been told where the money went. There was no evidence that the Appellants received the money. In Mr Kramer's submission this was a significant indicator that the Appellants were not parties to the fraud.

369. Mr Kramer referred to the evidence of Mr Monk in relation to XS Enterprise Systems Limited, where it took a maximum of 48 hours to deregister the company for VAT. A Regulation 25 letter had been issue the previous day. Mr Kramer submitted that Regulation 25 notices and the registration were tools that were available to HMRC to enable fraud be prevented.

370. Mr Bycroft gave evidence concerning the criminal convictions of one of the directors of the defaulting trader Midwest Communications. Information about criminal convictions was not available to the Appellants and they had no tools to investigate such matters, unlike HMRC.

371. Mr Kramer drew attention to the evidence of Ms Hirons. She stated that she did not uplift a computer belonging to the defaulting trader Zoom Products because she did not have authority to do so. Mr Kramer drew her attention to HMRC's powers under the Value Added Tax Act 1994. He suggested that the Tribunal should consider the manner in which evidence was given by HMRC officers and ask whether they were genuinely trying to assist the Tribunal to their maximum ability.

372. As regards Mr Fletcher's evidence, Mr Kramer queried whether Mr Fletcher had real experience of start-up companies. He also submitted that Mr Fletcher had used selective quotations from articles to indicate that there was no legitimate grey market. Mr Kramer also queried Mr Fletcher's evidence concerning Nokia pricing. He noted that Mr Fletcher had indicated that he had a direct relationship with Nokia but had relied on third-party information with regards to Nokia's sales. Mr Kramer noted that

Mr Fletcher had conceded that there was a significant grey market in Samsung handsets.

373. Mr Kramer drew attention to Mr Fletcher's statement that he has seen no evidence that the Appellants were involved in the retailing of airtime and his subsequent admission that he had not seen all the evidence in the appeals. In Mr Kramer's submission this demonstrated that Mr Fletcher was a partisan witness rather than a dispassionate expert.

374. Mr Kramer noted, however, that Mr Fletcher had accepted that mobile telephones with two pin chargers could be used anywhere in the world. Mr Fletcher had also accepted that the only way to undertake grey market trading was by back-to-back deals.

375. Mr Kramer also drew attention to Mr Stone's evidence that for external purposes the FTI was a legitimate organisation. Therefore, when the FTI discussed trading and advertised traders on their trading board, there was no reason for the Appellants to question their commercial credentials. It was not legitimate, some six years later and with the benefit of hindsight, to suggest that the Appellants should have asked more questions.

376. As regards the Appellants opening bank accounts with FCIB, Mr Kramer noted that Mr Stone had indicated that rumours had been circulating in the market that UK banks were closing the bank accounts of mobile phone traders. According to Mr Kramer, this was something that was being reported by the FTI. It was, therefore, something that the Appellants could legitimately consider and it was therefore appropriate and legitimate of the Appellants to have decided to open an account with FCIB.

377. Mr Kramer noted that in the evidence of Mr Stone and Mr Saunders it was accepted that "veto letters" simply stated that a trader had been deregistered (unless it was a case of a hijacked registration) and gave no reason for the deregistration. In Mr Kramer's submission these letters would not have put the Appellants on notice.

378. Mr Kramer also noted that Mr Stone had accepted that an exporter would have needed to generate greater profits than a domestic trader e.g. a buffer, because an exporter would be incurring significant transport costs and would also have to finance the carrying cost of the VAT prior to its repayment. On the question of why the Appellants' customers did not purchase the goods from a trader higher in the deal chains than the Appellants, Mr Kramer submitted that this was because not every trader had the financial muscle, resource and ability to export and finance the VAT repayment.

379. Mr Kramer drew attention to Mr Stone's agreement ("Potentially, yes.") that the increase in trading following the *Bond House* decision could have related to the increased certainty resulting from that decision.

380. In relation to Mr Saunders's evidence, Mr Kramer submitted that in a number of instances Mr Saunders appeared not to be attempting to be helpful to the tribunal e.g.

Mr Saunders had not wanted to accept that he knew that European Telecom was listed on the stock exchange and was a significant company.

381. Mr Kramer also submitted that Mr Saunders had accepted that it was normal for there to be trust between the customer and supplier, even if it was ill-advised. Mr Kramer made a submission in the context of the £4 million credit that had been extended to CSL by Adworks. Mr Kramer noted that Mr Dad had not been cross-examined on his evidence in relation to why Adworks advanced £4 million of credit to CSL.

382. Mr Kramer submitted that it was legitimate for the Appellants to carry out Europa checks on its trading partners rather than request a Redhill check. Mr Kramer noted that at no time had the Appellants been informed that Redhill was providing a service of anything other than checking VAT numbers.

383. As regards the letter from Nintendo, although Mr Saunders suggested that the letter was fraudulent, he had indicated that he saw no reason to investigate it.

384. The Appellants had used TSP to assist in due diligence. It was accepted that TSP was a legitimate organisation.

385. Mr Kramer invited this Tribunal to treat Mr Ruler's evidence in relation to Urban with extreme caution. He suggested that Mr Ruler was less than open in his evidence to the Tribunal. Moreover, no attempt had been made to require Mr Rahman to give evidence before the Tribunal so that his evidence could be heard directly and cross-examined.

386. In response to Mr Parroy's submission that it could not be coincidence that all of the trades in which the Appellants were involved led back to a tax loss, Mr Kramer submitted that the Appellants had not been told that the whole industry was fraudulent. The Appellants had not been told this and it was appropriate for them to rely on the information that was available.

387. As regards the registration of the Appellants for VAT, it had to be accepted that when a new businesses started it could not know with certainty exactly where the business will go. Mr Dad had indicated that he was going to undertake both retail and wholesale trading but when wholesale trading was more successful than retail trading. It was entirely sensible for him to invest resources and effort into wholesale trading.

388. Mr Kramer acknowledged that the Appellants' paperwork was not always up-to-date but submitted that this was common with small family companies. Mr Kramer submitted that the fact that Mr Dad has stated that one of the Appellants was going to enter into pharmaceutical trading but ended up trading in mobile phones should be disregarded. It was not being suggested by HMRC that Mr Dad was surreptitiously trading in mobile phones - he was open with HMRC about his trades.

Our decision

389. The Appellants accepted that all their transactions in respect of the periods under appeal were connected to the fraudulent evasion of VAT. The evidence of those HMRC officers who had responsibility for each of the defaulting traders was not challenged on this issue. It was also accepted that HMRC had incurred a tax loss through the fraudulent evasion of VAT by the defaulting traders in respect of each relevant deal chain.

390. We have concluded that the Appellants knew that their transactions under appeal were connected with the fraudulent evasion of VAT. We further conclude, in the alternative, that the Appellants should have known that their transactions were connected with the fraudulent evasion of VAT.

391. We have reached these conclusions having considered all the evidence and the submissions of the parties. The burden of proof lies on HMRC. We have applied the civil standard of proof, ie the balance of probabilities in reaching our conclusions.

392. Our reasons for reaching these conclusions are set out below. We should emphasise that the conclusions are based on the evidence considered as a whole rather than on any individual item of evidence. Some factors were, in our view, more compelling than others. Some aspects of the evidence were not conclusive by themselves but when viewed in the context of the evidence of the whole, supported our conclusion that the Appellants had actual knowledge that their transactions were connected with fraud.

393. For convenience, in the course of this decision we have indicated our views on particular issues or aspects of the evidence. In the following paragraphs we draw these strands together in order to explain our conclusions.

394. In reaching our conclusions we have borne in mind the words of Christopher Clarke J (at paragraph 110) in *Red 12 Trading* cited above and, whilst appreciating that every case must be judged on its own facts, agree with counsel for HMRC that they are particularly appropriate in this case:

> "To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands."

Actual knowledge of the Appellants

395. We base our conclusion that the Appellants knew that their transactions were connected with the fraudulent evasion of VAT on the following reasons.

396. As we have indicated at various places in this decision, we did not find Mr Dad to be a credible witness. We have no doubt that on a number of occasions his evidence was untruthful. During cross-examination he was repeatedly evasive and refused to engage directly with the questions being asked of him. We considered his evidence to be unreliable.

397. We consider that the incorrect trade descriptions given in respect of both CSL (pharmaceutical supplies) and CL (retail electronics) were intentionally misleading. We also note, in relation to CSL, that Mr Dad contradicted himself in relation to his knowledge that CSL had originally been registered with the purpose of making pharmaceutical supplies (see paragraphs 52 – 55).

398. Moreover, CSL's application to remain on monthly repayments, particularly the description of CSL's trading relationships attached to the letter of 25 January 2005, was, in our view, deliberately misleading. It indicated deliberate planning for an export trade.

399. In respect of CL's application for registration, there was a false statement that a supply had been made on 1 July 2005.

400. Mr Dad was fully aware of the risks of MTIC fraud. It was explained to him on numerous visits by HMRC officers in visits to his premises and in letters written to him by HMRC (see paragraphs 70 – 89).

401. Mr Fletcher's evidence, which we accepted, made it clear that the Appellants' transactions were not part of the legitimate grey market. The Appellants failed to sufficiently specify the goods in which they were dealing in their invoices and purchase orders. Moreover, Nokia's homogenous pricing policy effectively ruled out arbitrage trading. In addition, the Appellants traded unrealisticly high volumes of the mobile handsets in question. We concluded that the Appellants, as dealers in mobile phone handsets, were more likely than not to have known of these factors.

402. Deal 25 involving Datakey was, in our view, a telling piece of evidence. It revealed that Mr Dad knew the price paid by and therefore the mark-up made by his immediate supplier. There seemed to be, in our view, no credible alternative explanation for the issue of the first payment. Certainly we did not consider Mr Dad's explanation to be remotely credible. It showed that Mr Dad knew more than he claimed and, in our view, was a significant indicator that Mr Dad was aware that the dealings of the Appellants were connected with the fraudulent evasion of VAT.

403. The trading patterns and trading behaviour of the Appellants clearly indicated that the transactions subject to this appeal were contrived. In our view, these transactions manifested few features in common with legitimate trading transactions.

(1) All the deals of the Appellants in the periods under appeal traced back to 11 defaulting traders.

(2) The buffer deals in which the Appellants participated contained significant features which indicated contrivance. Mr Saunders's evidence was that all the buffer deals in which the Appellants featured traced back to defaulting traders. In 63 of the 103 deals where CL acted as a buffer trader the deal chains featured one of the 11 defaulting traders appearing in the transactions which form the subject matter of these appeals (paragraph 137). In respect of the 77 deals where CSL acted as a buffer trader 71 deals also featured one of the 11 defaulting traders appearing in the deal chains in respect of these appeals. Moreover, in our view, the fact that the Appellants' buffer deals all or mainly traced back to defaulting traders and the fact that in a high proportion of the buffer deals the same defaulting traders as those in the Appellants' broker deals are involved could not be mere coincidence but indicated the Appellants' awareness of the overall scheme to defraud HMRC. (See paragraphs 139 – 144).

(3) The mark-ups made by the Appellants' suppliers showed a remarkable degree of consistency. Mr Dad's evidence was that he was unaware of his supplier's mark-ups. This was, in our view, shown to be untrue in relation to Deal 25 involving Datakey. However, the degree of consistency of the mark-ups made by the Appellants' suppliers, when considered in the context of the evidence as a whole, strongly indicates that the Appellants knew that their transactions were contrived. It is hard to understand how the Appellants, if they were dealing in genuine commercial transactions at arm's length, could unknowingly agree to buy goods from suppliers at a price which so consistently left the supplier with the same profit margin. (Paragraphs 149 – 150)

(4) The Appellants' profit margins were remarkably consistent. Again, it is hard to understand how such consistency could be achieved in an open market with parties dealing at arm's length. (Paragraphs 151 – 156).

(5) The chronological rotation of defaulting traders was an indication that the deal chains were contrived, although this does not by itself indicate actual knowledge of the Appellants that their transactions were connected with fraudulent evasion of VAT. Nonetheless, the rotation of defaulting traders is part of the overall factual background relating to the underlying VAT fraud. (Paragraphs 145 – 147)

(6) There was no reason why the Appellants' customers should purchase the goods from the Appellants (thereby incurring an additional mark-up) rather than sourcing the goods from traders lower down the deal chain. The evidence was that all the traders in the deal chain advertised on the same internet trading platforms. The trades took place within a very short timescale. There was no sensible reason why the customers would not seek, if trading in a rational and open market, to shorten the deal chains. We were unconvinced by Mr Dad's explanation. (Paragraph 157)

(7) The Appellants always occupied the same position in the deal chains (i.e. the fifth UK company in the deal chain). This occurred in every one of the 43 deal chains (including the un-appealed deals). It is hard to see how this could

arise otherwise than by virtue of the fact that the deal chains were contrived. (Paragraphs 159 – 160)

(8) There was no evidence of negotiation of any of the deals which were the subject of these appeals (or, for that matter, in respect of the un-appealed deals). (Paragraph 161 – 162)

(9) The rapid and huge increase in turnover of both the Appellants was highly suspicious. The Appellants had very little capital and Mr Dad had no previous experience of wholesale trading in mobile phones. The actual turnover achieved by the Appellants contrasted markedly with the estimated turnover stated in the Appellants' application for registration for VAT. (Paragraph 163-164)

404. As regards due diligence, many of the TSP reports were produced after the Appellants had commenced trading with the companies concerned. In some cases, the reports were produced after all the trades, in the relevant period with a particular company, had been concluded. We did not find Mr Dad's explanation, that these reports were merely the latest version of earlier reports, to be credible. These were the reports exhibited to Mr Dad's witness statement. It was obviously important to produce a report which indicated the Appellants' state of knowledge at the time the transactions were concluded. If there had been earlier reports they would surely have been exhibited to Mr Dad's witness statement.

405. In addition, there was no credible evidence that Mr Dad took heed of warnings or matters of concern arising from these reports. For example, in relation to URTB, there were a number of matters which should have given rise to serious concern (including the wrongful signature by the company secretary of the director's self-certification) but which left Mr Dad untroubled.

406. After receiving the warning letters issued by HMRC on 23 January 2006, alerting the Appellants to the fact that earlier transactions had been traced back to VAT fraud, Mr Dad continued to deal with three suppliers (Mobile Heaven, Inter Communications and AR) in February and March 2006 without any apparent updating of existing due diligence. (Paragraph 223 – 227)

407. Furthermore, the Appellants did not begin to record IMEI numbers (a reference number unique to each mobile handset) until September 2006 and only then because HMRC had directed the Appellants to do so. Mr Dad had previously been advised to record this information to ensure, for example, that the goods had not been stolen. (Paragraphs 228 – 237)

408. In relation to Adworks, the evidence showed that in April 2005, before the transactions in respect of the present appeals were concluded, CSL had permitted the supplier of its immediate supplier to deliver stock directly to CSL's customer. By this action CSL risked being cut out of future deals. This strongly suggested that CSL was involved in trade which was not founded on legitimate commercial principles. (Paragraph 264-271)

409. We considered that CSL operated in conjunction with Goldex and GIP, resulting in a further clear indication that CSL was aware that its transactions were contrived.

The similarities in the deal chains and the mark-ups made by the immediate suppliers of Goldex, GIP and CSL were not, in our view, matters of coincidence. We did not find Mr Dad's statement that he was unaware of his brother's activities to be credible.

410. In relation to the FCIB evidence, we did not accept Mr Dad's evidence about his reasons for opening an account for CSL with FCIB (i.e. that he was concerned that his account with Bank of Scotland would be closed). We did not consider the reason he gave to be credible. (Paragraph 293-300)

411. The evidence of the Dutch FCIB server clearly indicated the circular nature of the deal chains and the fact that the deal chains were contrived.

412. The evidence in respect of the Paris FCIB server of loans from the Padani sub-account to CSL plainly connected CSL (and Mr Dad) to those persons operating the VAT fraud. This evidence, therefore, simply added further confirmation that the Appellants knew that their transactions were connected to the fraudulent evasion of VAT.

413. The admission and the provenance of the Paris FCIB server evidence were disputed. We should make it clear, however, that we would have reached the same conclusion even if the evidence in respect of the Paris FCIB server had not been admitted. In our view, the cumulative evidence (disregarding the evidence from the Paris FCIB server) was overwhelming and plainly showed that the Appellants had actual knowledge that their transactions were connected with fraud.

Means of knowledge

414. Having concluded that the Appellants had actual knowledge that their transactions were connected with the fraudulent evasion of VAT, it is strictly unnecessary for us to decide whether they ought to have known that their transactions were so connected. However, for completeness and alternatively, we consider that the Appellants ought to have known that their transactions were connected with the fraudulent evasion of VAT.

415. In reaching this conclusion, we rely on the reasons referred to above under the heading "*Actual knowledge of the Appellants."*

416. In addition, in reaching our conclusion under this heading, we rely on the fact that the Appellants were, in every transaction under appeal, able to sell their stock and make profits without being left with any unsold stock or having defective stock returned. They never had to split a purchased batch and sell sub batches to different customers at different times. They never merged purchased batches into larger consignments. They were able to grow their business at speed to enormous volume without adding any value to the goods by manipulation or skill. Very simply, the adage ‘too good to be true’, ought to have warned them that fraud was the mechanism underlying their success.

417. The Appellants were able to obtain large amounts of credit even though they had a short trading history, limited capital and no credit agreements in place. (Paragraph 266 – 270)

418. Finally, all the transactions under appeal involved handsets with two pin chargers. There was no obvious reason why such goods would be imported into the UK and traded between UK traders.

Conclusion

419. For the reasons given above, we dismiss these appeals.

Costs

420. The Tribunal has already directed that Rule 29 Value Added Tax Tribunals Rules 1986 shall apply to these appeals and HMRC have indicated that if the appeals were dismissed they would seeking their costs. Accordingly, we direct that the Appellants pay the reasonable costs of HMRC, the amount to be assessed by a costs judge, if not agreed.

421. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

GUY BRANNAN

TRIBUNAL JUDGE
RELEASE DATE: 16 December 2011