# TC02291

**Appeal number: TC/2011/07415**

***Value Added Tax Act 1994 sec 84(7B) & Sch 11 para 6A – Directive 2006/112 Art 273 – Direction to keep records – scope of appeal jurisdiction – proportionality – risk of tax loss – appeal allowed***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**DEMAZDA INTERNATIONAL UK LIMITED**

**appellant**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS** **respondents**

**TRIBUNAL: JUDGE MALACHY CORNWELL-KELLY**
**Ms SUSAN J LOUSADA BSc, PGC**

**Sitting in public at 45 Bedford Square London on 24 & 25 July 2012**

**Mr Nicholas Yeo instructed by Jeffrey Green Russell for the taxpayer**
**Mr Matthew Donmall instructed by the Solicitor's Office of HMRC for the Crown**

## DECISION

### Introduction

1 This is an appeal against a Direction given by the commissioners on 14 June 2011 directing Demazda International UK Limited ("Demazda") to keep specified records in relation to value added tax. The Direction was given under paragraph 6A of Schedule 11 to the Value Added Tax Act 1994, inserted by section 21 of the Finance Act 2006, on the basis that the commissioners had reasonable grounds for believing that the records specified might assist in identifying taxable supplies in respect of which VAT might not be paid.

2 The main issues raised in the appeal, which we are told is the first of its kind in relation to these powers, are: (i) whether the facts of the case fell within the scope of the commissioners' statutory powers, (ii) whether such powers, or their exercise in this case, offend the Community law principle of proportionality, (iii) how the appeal provisions should be construed.

3 We received witness evidence from two officers, the case officer Ms Jane Matthews and her supervising officer Mr Terence Demand (who issued the commissioners' Direction), and from Mr Costas Kotrofis on behalf of the appellant company. We also received a sizeable quantity of documentation. We regarded all three witnesses as honest and doing their best to give accurate evidence; Ms Matthews and Mr Kotrofis were however often hesitant or unsure in their responses to questioning. Where we do not accept what they said, we indicate that explicitly.

### Legislation - Value Added Tax Act 1994

4 Schedule 11, paragraph 6A-

6A(1) The commissioners may direct any taxable person named in the Direction to keep such records as they specify in the Direction in relation to such goods as they so specify.

(2) A Direction under this paragraph may require the records to be compiled by reference to VAT invoices or any other matter.

(3) The commissioners may not make a Direction under this paragraph unless they have reasonable grounds for believing that the records specified in the

Direction might assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid.

(4) The taxable supplies in question may be supplies made by-

(a) the person named in the Direction, or

(b) any other person.

(5) A Direction under this paragraph-

(a) must be given by notice in writing to the person named in it,

(b) must warn that person of the consequences under section 69B of failing to comply with it, and

(c) remains in force until it is revoked or replaced by a further Direction.

(6) The commissioners may require any records kept in pursuance of this paragraph to be preserved for such period not exceeding 6 years as they may require.

(7) Subparagraph (4) of paragraph 6 (preservation of information) applies for the purposes of this paragraph as it applies for the purposes of that paragraph.

(8) This paragraph is without prejudice to the power conferred by paragraph 6(1) to make regulations requiring records to be kept.

(9) Any records required to be kept by virtue of this paragraph are in addition to any records required to be kept by virtue of paragraph 6.

5 Section 83 provides, so far as material-

(1) Subject to section 84, an appeal shall lie to a tribunal with respect to any of the following matters-

(zza) a Direction under paragraph 6A of Schedule 11;

6 Section 84 provides, so far as material-

(1) References in this section to an appeal are references to an appeal under section 83.

(7B) Where there is an appeal against a decision to make such a Direction as is mentioned in section 83(zza)-

(a) The tribunal shall not allow the appeal unless it considers that the commissioners could not reasonably have been satisfied that there were grounds for making the Direction;

(b) the Direction shall have effect pending the determination of the appeal.

7 Section 69B provides-

(1) If any person fails to comply with a requirement imposed under paragraph 6A(1) of Schedule 11, the person is liable to a penalty.

(2) The amount of the penalty is equal to £200 multiplied by the number of days on which the failure continues (up to a maximum of 30 days).

(3) If any person fails to comply with a requirement to preserve records under paragraph 6A(6) of Schedule 11, the person is liable to a penalty of £500.

8 Regulation 31 of the Value Added Tax Regulations 1995 provides:

31(1) Every taxable person shall, for the purpose of accounting for VAT, keep the following records—

(a) his business and accounting records,

(b) his VAT account,

(c) copies of all VAT invoices issued by him,

(d) all VAT invoices received by him,

…

(h) documentation relating to importations and exportations by him,

(i) all credit notes, debit notes, or other documents which evidence an increase or decrease in consideration that are received, and copies of all such documents that are issued by him

…

9 Article 273 of Directive 2006/112 provides:

Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion, subject to the requirement of equal treatment as between domestic transactions and transactions carried out between Member States by taxable persons and provided that such

obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.

The option under the first paragraph may not be relied upon in order to impose additional invoicing obligations over and above those laid down in Chapter 3.

10 Guidance for the use of officers giving directions under paragraph 6A, issued by the commissioners early in 2006, includes the following:-

**3 Application of the Measure**

3.1 Notices of Direction must be used appropriately, proportionately and with care…

3.3 For a Direction the following criteria must be met

Businesses with an established trading

There must be evidence that the business or one or more of its key personnel (which could include the proprietor, director, 'shadow' director, shareholder or key employee such as a sales manager) has previously been involved in a transaction chain that commence with a significant tax loss. A transaction chain includes any 'contra chain' contrived to off-set a repayment claim, where we have grounds to believe that this forms part of an overall scheme to defraud the revenue.

…

3.3[sic] If the recommending officer considers that, although the business concerned fulfils some of the above criteria, it is not participating and is not likely to participate in transaction connected with MTIC fraud, then they should not recommend the making of a Direction.

**4 The Notice of Direction**

4.1 In the first instance businesses meeting the criteria should be asked to keep a record, on the basis of each unit of stock received, which will include the following information:[1]

…

[1] The information is then listed exactly as it appears on page 1-2 of the Direction in the current case.

4.5 A template of a Notice of Direction is attached at Annex A.

**5 Handling Cases: General Principles**

5.1 HMRC's decision-making process will be closely inspected in any appeal so it is important to remember the following principles when making a decision to make a Direction:

- You must look at each case on its own merits

- Take all the relevant factors into account

- Do not take account of irrelevant factors

- As with all HMRC powers, we are required to apply the power in a reasonable and proportionate manner. This means taking account of the burden that compliance with the measure will place on the taxpayer concerned, balanced against the seriousness of the risk (ie the likelihood and level of revenue risk in the particular case concerned) that the notice of Direction is designed to address.

**6 Person making the recommendation**

6.1 The recommendation on whether or not to make a Direction should be made by the case officer who has the most detailed knowledge of the circumstances of the business.

**7. Role of the Senior Officer**

7.1 The relevant Senior Officer should review the recommendation of the case officer and take the decision as to whether or not reasonable grounds (as defined in section 3 above) exist. As part of this process, the senior officer should:

- Consider the strength of the evidence, i.e. that it is sufficient to establish that there are reasonable grounds to believe the records might assist in identifying MTIC supplies, and

- Ensure that all relevant facts have been taken into consideration, that no irrelevant facts have been taken into account and that the making of the Direction is a proportionate use of the power.

- If satisfied on all these points, the Senior Officer should make the Direction and give it by notice in writing to the person named in it.

**Facts**

11 We find the facts stated hereafter established, at least on the balance of probabilities.

12 Demazda was incorporated on 19 July 2005 and subsequently registered for VAT in June 2006, but deregistered in 2008 because it had not made any taxable supplies since registration. Demazda was re-registered for VAT as from 1 January 2010, its main business activity being described as "wholesale of retail trade of consumer products, digital cameras, lenses, photo printers". Control visits took place on 4 and 11 May 2010, when officer Matthews was told that although Mr Kotrofis owned the company, he was not a director on account of being the subject of an "Insolvency Voluntary Arrangement"; Notice 726 about joint and several liability in the event of tax in connected transactions going unpaid was given.

13 The officer decided to monitor Demazda's sales and purchases on a monthly basis and on 17 May 2010 requested a monthly analysis consisting of details for suppliers and customers of invoice numbers and dates, quantities, description of goods with prices and tax. A second control visit took place on 13 December 2010, and a detailed reporting regime was established following a request to include further information in the monthly analysis made on 9 February 2011 – the details of payments, bank statements, movement records, due diligence checks, correspondence with suppliers and customers and "any other relevant documentation relating to trade carried out".

14 These details were needed to establish the integrity of the deal chains, and at all times officer Matthews found that she got full cooperation from the company and she told us that her senior officer would have known that.

15 A further control visit took place on 9 June 2011, Ms Matthews having written to Demazda on 25 May 2011 notifying it that 22 out of 33 transactions in which it had been involved for the period from 05/10 to 02/11 – 1 March to 30 November 2010 - had led back to a defaulting trader and a tax loss of VAT totalling at least £945,219, giving details of each transaction. Ms Matthews told us that she considered these losses to be due to fraudulent evasion, based on the opinion of the case officer dealing with the tax loss trader at the start of each chain; but Ms Matthews was unable to say whether in any of these cases assessments had been issued, appeals lodged or prosecutions commenced.

16 The visit report records that the officer (who was accompanied by a junior officer) saw a Mr Benali, a director of Demazda, and Mr Costas Kotrofis, the sales director; Demazda traded in electrical goods and the officer saw the sales invoices, the purchase invoices, the payment instructions, the bank records and the logistic files, and satisfied herself that reasonable commercial checks were being carried out.

17 Officer Matthews then made details notes by way of report to her senior officer, Mr Demand; she noted the following-

Mr Mann, an accountant and a director, was said not to be involved in the day to day running of Demazda but gave advice and support to Mr Kotrofis. Messrs Mann and Benali were said to have joined Demazda as an investment, though it had not proved a good one; they both owned a company called Sea Vision International which bought and sold yachts, and Mr Benali worked in sales for Commonsense Limited, which dealt in mobile phones subject to the reverse charge mechanism. All three men had previously worked for Global Telecoms and had been involved in their having been denied input tax of £8.5M in 2006 (see below).

Demazda bought goods in the UK and sold them on quickly without taking physical possession of them, the goods remaining in warehouse for the very short time that Demazda owned them; written contracts were used with their bigger customers. The officer recorded details of the due diligence carried out, making no adverse comment about it. In particular, Mr Kotrofis now went to check goods in the warehouse himself and recorded EAN[2] numbers relating to the batch in each deal.

When officer Matthews said that she would probably send a letter directing the keeping of the EAN numbers, Mr Kotrofis responded that he was keeping them already. In oral evidence, Ms Matthews said that she might have been confused about the difference between EAN numbers and individual serial numbers, and have meant to ask for individual numbers because she had already had a discussion with Mr Demand about that. There is no evidence of her having done so and she did not recall asking for records of individual items. We find that she did not do so.

After discussing several individual deals, officer Matthews noted her conclusions. They recorded that this was an ongoing monitoring of Demazda "in the Buffer project" and that she had been promised copies of bank statements, the management account and the full year-end accounts; deal packs would continue to be sent to her.

18 Ms Matthews concluded her note-

It certainly seems that Mr Benali and Mr Mann would have had knowledge of MTIC[3] from their previous dealings at Global Telecom and Mr Benali understands the implications of the tax loss warnings given to Demazda.

19 The matter then passed to senior officer Terence Demand to consider whether a Direction under paragraph 6A should be made.

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[2] European Article Number

[3] Missing Trader Intra-Community fraud.

20 Senior Officer Demand made notes on 14 June recording his review of the case-

Reviewed the background to this trader's MTIC risk and its involvement in MTIC activity. The company is buying and selling high value electronic goods that are not within the reverse charge liability. The transactions have been established as involving deal chains where each party acts as a wholesaler and buys and sells in back to back deals.

The enquiries made by [officer Matthews] have established that most of the deals carried out from March to November 2010 commence with a tax loss from a fraud against the revenue. The remaining transactions carried out are still under enquiry and are likely also to be linked to fraud.

Further, a director of the company, since October 2010, Jim Mann, was the financial director of Global Telecoms Distribution Limited, a company where a large number of transactions involving tax losses from fraud were identified and notified over at least 3 tax periods.

Due to the risk identified and the need to be able to identify the actual individual products being bought and sold, I am satisfied that the Direction is reasonable and proportionate to the risk identified.

21 The Direction of 14 June 2011 was expressed to be issued for two reasons:

1 A director of [Demazda] was previously a director of a business where significant tax losses from fraud were identified by HMRC and notified to that business.

2 There have been tax losses in 22 of the deal chains that [Demazda] has been involved in during the period March to November 2010, with tax fraud of £948,668 so far identified. There are further transactions still being investigated.

22 A review was requested and on 25 August 2011 the commissioners upheld the issue of the directions. An appeal was lodged on 16 September following.

23 The contested Direction required the keeping of records of 22 matters. In specific terms, it required-

A record that will show, for each unit of stock purchased, the following information:

24 There followed a list of the information required, almost all of which was already required to be recorded pursuant to the generally applicable regulations made under paragraph 6 of Schedule 11. The two extra requirements to which Demazda particularly objected were –

Where they exist unique serial numbers of individual items, or if appropriate batch and/or lot numbers, or in the case of mobile phones unique IMEI numbers, or in the case of CPUs box and lot number.

Weight.

25 It is to be noted that the Direction required that all the matters covered should be contained in "a record", thus making it possible for the commissioners to see all the information required in one document, rather than having to collate it from separately kept records in relation to each item.

26 In evidence, Mr Demand stated that he judged that HMRC could not rely "on a long term basis" on Demazda continuing to provide the information it had been providing, and he held that view because his experience was that once a business had been advised of tax losses it would withdraw cooperation. The senior officer could not recall whether he had discussed with officer Matthews the need for serial numbers for individual items, as distinct from the EAN batch numbers already kept, and accepted that there was no record of that or of his reasons for wanting to include all 22 items in the Direction and he had seen no need to record everything of his thinking.

27 Mr Demand explained to us that having the serial numbers of goods made it easier to construct an audit trail for them, by checking with the original equipment manufacturer that they existed and when they were produced, checking import and export records to ascertain whether they had been traded before and checking other sources of information to establish the integrity and authenticity of the supply chain. Likewise, in relation to weight, the data would be useful in checking that goods of the description given did in fact have that weight and in checking that it tallied with the other details of the transaction such as the stated means of transport.

28 The contents of the Direction followed a template in the document called "Guidance on power for HMRC to direct additional record keeping requirements", issued in 2006 when the powers were enacted. Senior Officer Demand said that he had not referred to the Guidance, but had taken his text from previous directions he had issued – he had done 12 in all – though the Direction letter he issued follows the Guidance template exactly, particularly in the list of matters in respect of which records were to be kept.

29 We find that the case officer made no specific recommendation to the senior officer, as required by the Guidance, and that he did not ask for one. Mr Demand's explanation for this was that Ms Matthews was relatively inexperienced – she had been doing this work only since May 2009, for two years – and he had had the benefit of dealing with the 12 previous such cases.

30 The director whose presence at Demazda was mentioned as the first reason for the Direction, having been also "a director of a business where significant tax

losses from fraud were identified by HMRC", was a Mr Jim Mann. Mr Mann resigned his directorship of Demazda on 10 June and filed notice of it to Companies House electronically the same day; he was thus no longer a director of Demazda when the Direction was issued on 14 June, and it appeared that he had ceased his association with the company. HMRC did not make the simple electronic search needed to confirm whether Mr Mann was still a director of Demazda before issuing the Direction, and the first reason for the Direction was thus factually incorrect.

31 The previous company of which Mr Mann had also been a director, was Global Telecoms Distribution Plc, in relation to which it was found by the tribunal on 25 August 2010 that it had not been proved that it knew or ought to have known that transactions in respect of which it had been denied input tax were connected with the fraudulent evasion of VAT. But that fraudulent evasion had taken place in the transactions upstream of Global Telecoms was, however, accepted in the appeal.[4]

32 It was therefore misleading to say of Global Telecoms that it was "a business where significant tax losses from fraud were identified", with the implications that the losses were at Global Telecoms, or that Global Telecoms had been aware of them. Neither was the case. In so far as Demazda's own transactions were concerned, Mr Demand conceded in evidence that the suppliers in question were either missing or defaulting traders, notwithstanding that he had recorded in his pre-Direction notes that Ms Matthews's enquiries "have established that most of the deals carried out from March to November 2010 commence with a tax loss from a fraud against the revenue". We find that at the time, Mr Demand thought that fraud was involved.

33 As to the suitability of a Direction to the position of Demazda, Mr Demand insisted that the Direction was "tailored" to their circumstances, though there is no corroborating evidence that consideration was in fact given to that issue; the review note reproduced above indicates that the factor which uniquely informed the decision to issue the Direction was the risk to the revenue, and nothing in Mr Demand's evidence convinced us otherwise. The exact correspondence of the Direction with the template offered by the Guidance points to the Direction having been made mechanically and without reflection, as does the reference in the Direction again copied from the 2006 template to the trader's right of appeal to the VAT and Duties Tribunal - a jurisdiction which had ceased to exist more than two years earlier.

34 The terms in which the two contested requirements were expressed, and the irrelevant references to mobile phones and CPUs, also point to a lack of thought in the preparation of the Direction. Thus, the reference relating to serial numbers was ambiguous: a requirement to record "unique serial numbers of individual items, or if appropriate batch and/or lot numbers" was certain to cause confusion

[4] *Emblaze Mobility Solutions Ltd v CRC* [2010] UKFTT 410 (TC).

to a business which was already recording EAN batch numbers, and which had been informed by the case officer 5 days previously that it would be formally required to record them.

35 Mr Kotrofis was in fact confused and Mr Demand asserted in a telephone call from Mr Kotrofis on 12 June that individual serial numbers were required; on 24 June, Mr Kotrofis emailed that he needed this put in writing. Mr Demand's explanation to us of the otiose requirement to record the serial numbers of mobile phones and CPUs was that it was "illustrative" of the kind of records HMRC wanted.

36 The situation was also unclear in the case of the second contested requirement, to keep records of "weight". Grammatically, this meant the weight of each item of goods traded, since the Direction specified records "for each unit of stock purchased". Mr Kotrofis subsequently queried this and was told by telephone on 21 June that the Direction was referring to the "gross weight for each pallet", which it was possible to obtain from the warehouse; Mr Demand, who had taken the call, then added that the weight requirement might be dropped so long as individual serial numbers were obtained. At the hearing, Mr Demand was asked to confirm the meaning of "weight" and, at our request, he then dictated to us his definition as-

The gross palletised weight of the *overall* consignment of the particular volume of goods i.e. the weight of any distinct *class* of goods on the invoice. (emphasis added)

37 Once it had been made clear that the requirement was to keep individual serial numbers, Mr Kotrofis protested on 24 June that to do so was effectively impossible in the circumstances of his business, citing the rapidity with which transactions had to be completed in Demazda's type of market, the hopelessness of trying to do this if the goods were abroad, the prospect of devaluing the goods if packaging had to be broken, his lack of staff and the narrowest of margins on which the business traded. Instead, Mr Kotrofis proposed random sample checks on perhaps 10% of his trade. It was at this point that Mr Kotrofis informed Mr Demand that he had purchased a scanner and was waiting for its installation; it would be feasible to use this if the flexibility requested were to be agreed.

38 Mr Demand addressed these issues of interpretation in a three page letter to Demazda on 27 June. First, the senior officer noted the claim that Messrs Mann and Benali were no longer directors and said that he would carry out "independent checks" to verify the resignations; he reiterated that the risk to the revenue remained and explained in detail how it came about. Concerning the recording of serial numbers, Mr Demand said this-

This leads me on to your point on our requirement for your company to obtain and record the individual serial numbers of the goods you may trade in the future. To clear up an ambiguity, the term in the notice 'if appropriate' against the

wording of serial numbers, relates to whether the goods being traded actually have individual serial numbers. If the goods do have such numbers, they must from now on be obtained and recorded together for the whole batch bought and sold as a group. If the goods traded do not have individual serial numbers, then other distinguishing commercial markings should be recorded and kept.

I'm afraid I cannot vary the requirement to obtain and retain individual item serial numbers of goods that the company buys and sells, which it is required to declare on its UK value added tax returns. The reason is that, due to the tax fraud risk that has been established in the company's trade, we are concerned that the risk of fraud in the transactions will continue due to the way the transactions take place, particularly while the goods are held in third party premises that you do not have day to day control over.

Over the last 10 or so years we have established that there is a risk when goods are traded in this way that products are not as specified on the invoices or order notes.

39 Mr Demand then discussed his understanding of the necessity and possible effects of breaking packaging to find serial numbers - adding that he would not have required cartons actually to be opened -

To the fraudster, the opening of the outer carton makes them undesirable for a subsequent use as the tax and border authorities will take an interest in subsequent shipments of the cartons.

40 Finally, Mr Demand declined the concession requested of recording only a 10% sample.

41 The letter of 27 June was not, and did not purport to be, a revision and re-issue of the Direction under the commissioners' powers, or a revocation of it. We find Mr Demand's explanations in the course of the appeal for the terms of the Direction about serial numbers and weight unconvincing, and at odds with the contemporaneous evidence that the document was simply prepared from a template without due consideration of the circumstances of the case.

42 At the hearing, the appellant put in evidence a sales analysis summary for the periods March 2010 to June 2011, to which had been added a further analysis showing the profit margin of each transaction; the margins varied considerably and, taking out three exceptional losses, the margins ranged from 0.47% to 5.51%. A further analysis for the same periods showed that 62.5% of the appellant's sales were to eBuyer, 20.3% to Impact Tech, 6.2% to Dabs.com and 6% to Northamber Plc. But the evidence also showed that eBuyer and dabs.com by no means always acted as retailers and often sold on to other wholesalers; this was the case in 15 of the 22 transactions to eBuyer identified as involving a tax loss somewhere in the chain.

43 In evidence, Mr Kotrofis agreed that serial numbers must be available for goods at the start of the chain when they leave the manufacturer, and that either his suppliers or his customers would have access to the serial numbers themselves. Though obtaining the information from commercial suppliers would not of itself involve any cost as such, Mr Kotrofis's evidence was that to request such information often meant that suppliers would decline to sell to Demazda.

44 Mr Kotrofis also said that freight forwarders could provide these details of the serial numbers at 6p per unit, though the delay involved in that or in scanning by Demazda could mean that a transaction could not be done quickly enough and would not take place. No overall calculation was put to us to show the percentage the cost of scanning or reports from a freight forwarder would represent of Demazda's gross profit, but random calculations on the basis of the schedule put in evidence suggest that it would vary widely putting more pressure on the profitability of some transactions than others, and in some cases removing it altogether.

45 Much correspondence continued between Demazda and the commissioners for the rest of 2011 and into 2012, about on the feasibility and the desirability of the Direction and its terms. Whether, in view of what passed then, it would have been useful to revoke the Direction and start again is a matter for the commissioners. The tribunal's jurisdiction is however to focus on the Direction actually given when it was given, and whether the commissioners could reasonably have been satisfied that there were grounds for giving it, and it would serve little purpose therefore to offer an account of the later correspondence.

**Submissions**

46 We have been much assisted by full arguments from both counsel, in particular their closing submissions, the substance of which is as follows.

**For the taxpayer**

**1 UK law**

47 On the face of it, the sole limitation on the imposition of a Direction under paragraph 6A of Schedule 11 of the 1994 Act is the requirement to have "reasonable grounds for believing that the records specified in the Direction *might* assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid." This might appear to suggest that the commissioners are free to impose any Direction, no matter how onerous and no matter how marginal the benefit. However, in this as in many of their duties, the commissioners are obliged to act proportionately.

48 The test "*to have reasonable grounds for believing"* in paragraph 6A(3) appears elsewhere in legislation and has been considered in the case law. There are two important aspects of its construction:

To have *reasonable grounds for believing a thing* means that the person believes that thing upon reasonable grounds. It is subjective as well as objective. If the person does not actually believe the thing but after the event demonstrates that had he so believed he would have done so with reasonable grounds, the test would not be satisfied.

The *reasonable grounds* concerned are those that were as a matter of fact in the mind of the person at the time, not those that may be postulated retrospectively.

49 In *O'Hara v Chief Constable of the Royal Ulster Constabulary* [1997] AC 286, where the issue related to the test in section 12(1) of the Prevention of Terrorism (Temporary Provisions) Act 1984 which gave power to a constable to arrest a person without warrant if he had *reasonable grounds for suspecting* that he was concerned in acts of terrorism, Lord Hope said (at 298):

In part it is a subjective test, because he must have formed a genuine suspicion in his own mind that the person has been concerned in acts of terrorism. In part also it is an objective one, because there must also be reasonable grounds for the suspicion which he has formed. But the application of the objective test does not require the court to look beyond what was in the mind of the arresting officer. It is the grounds which were in his mind at the time which must be found to be reasonable grounds for the suspicion which he has formed.

50 In *Saik* [2007] 1 A.C. 18 Lord Hope applied this approach to section 93C of the Criminal Justice Act 1988 (which holds that a person is guilty of an offence if he deals with property, knowing *or having reasonable grounds to suspect* that it is the proceeds of criminal conduct) at [52]:

… The subjective test—actual suspicion—is not enough. The objective test—that there were reasonable grounds for it—must be satisfied too.

…The subsection assumes that a person who is proved to have had reasonable grounds to suspect that the property had a criminal origin did in fact suspect that this was so when he proceeded to deal with it. A person who has reasonable grounds to suspect is on notice that he is at the same risk of being prosecuted under the subsection as someone who knows. It is not necessary to prove actual knowledge, which is a subjective requirement. The prosecutor can rely instead on suspicion. But if this alternative is adopted, proof of suspicion is not enough. It must be proved that there were reasonable grounds for the suspicion. In other words, … [the] requirement contains both a subjective part—that the person suspects— and an objective part—that there are reasonable grounds for the suspicion.

51 See also the judgment of Lord Brown (at paragraph 108).

52 The paragraph 6A power supplements other record keeping provisions of the Act by which all taxable persons must keep detailed records of all transactions to

which VAT applies. By paragraph 6 of schedule 11, "every taxable person shall keep such records as the commissioners may by regulations require". Such regulations are provided by Regulation 31 of the Value Added Tax Regulations 1995.

53 In regard to penalties, it is provided that if any person fails to comply with a Direction to keep specific records imposed under paragraph 6A(1) of Schedule 11, the person is liable to a penalty of £200 multiplied by the number of days on which the failure continues (up to a maximum of 30 days) (s69B(1)) (unless if the person concerned satisfies the commissioners (or tribunal) that there was a reasonable excuse for the failure (69B(6))). By contrast, a failure to keep the records required of all taxable persons under paragraph 6 is punishable with a penalty of £5-15 per day (section 69(2)) and a failure to preserve them for 6 years, with a penalty of £500 (section 69(3)). This, if a Direction to keep specific records under paragraph 6A is made in respect of records that are already subject to an obligation to keep by reason of paragraph 6, the effect is to increase the penalty for default from £5-15 to £200 per day.

**2 EU law**

54 The commissioners must exercise their power under paragraph 6A in a proportionate and reasonable way. The principle of proportionality in Community law is enshrined in article 5 of the EC Treaty:

Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty.

55 It follows that a domestic measure providing for the enforcement of a Community obligation must be proportionate.

56 In regard to VAT, the Principal VAT Directive, 2006/112/EC ("the VAT Directive"), prescribes the measures adopted by Member States for the collection of VAT. As a directive, Member States are obliged to enforce its requirements, though the manner in which enforcement is undertaken is within the discretion of the state. The principle of proportionality is applicable to national measures which are adopted by a Member State in the exercise of its powers relating to VAT, since, if those measures go further than necessary in order to attain their objective, they would undermine the principles of the common system of VAT.

57 It follows that the measures adopted by the Member States with respect to the administration and collection of VAT must be proportionate that is to say that they:

Must go no further than is necessary for the purpose of preserving the right of the Treasury to collect the tax.

Must be the least detrimental to the objectives and the principles laid down by the relevant Community legislation.

May not be used in such a way that they would have the effect of systematically undermining the right to deduct VAT.

58 In *Garage Molenheide BVBA and others v Belgium* (joined cases C-286/94, C-340/95, C-401/95 and C-47/96) [1998] STC 126 the European Court of Justice accepted a national provision under which the tax authorities have the power to delay refunds of VAT until the validity of the claim has been definitively established, albeit that the application of the measure must be proportionate.

59 The judgement states:

[46] Thus, in accordance with the principle of proportionality, the Member States must employ means which, whilst enabling them effectively to attain the objective pursued by their domestic laws, are the least detrimental to the objectives and the principles laid down by the relevant Community legislation.

[47] Accordingly, whilst it is legitimate for the measures adopted by the Member States to seek to preserve the rights of the Treasury as effectively as possible, they must not go further than is necessary for that purpose. They may not therefore be used in such a way that they would have the effect of systematically undermining the right to deduct VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation.

[48] The answer to be given in that regard must therefore be that the principle of proportionality is applicable to national measures which, like those at issue in the main proceedings, are adopted by a Member State in the exercise of its powers relating to VAT, since, if those measures go further than necessary in order to attain their objective, they would undermine the principles of the common system of VAT and in particular the rules governing deductions which constitute an essential component of that system.

[49] As regards the specific application of that principle, it is for the national court to determine whether the national measures are compatible with Community law, the competence of the Court of Justice being limited to providing the national court with all the criteria for the interpretation of Community law which may enable it to make such a determination ….

60 The Court of Justice returned to the matter in *Teleos* [2008] QB 600 (ECJ), where it was said:

[45] As is clear from the first part of the sentence in article 28c(A) of the Sixth Directive, it is for the Member States to lay down the conditions for the application of the exemption of intra-Community supplies of goods. It is

important to note, however, that when they exercise their powers, Member States must comply with the general principles of law which form part of the Community legal order, which include, in particular, the principles of legal certainty and proportionality: see, to that effect, Garage Molenheide BVBA v Belgian State (Joined Cases C-286/94, 340 and 401/95 and 47/96) [1997] ECR I-7281 , para 48, and Customs and Excise Comrs v Federation of Technological Industries (Case C-384/04) [2006] ECR I-4191 , paras 29 and 30.

…

[52] …, as regards the principle of proportionality, it must be recalled that the court held, in para 46 of its judgment in the Molenheide case [1997] ECR I-7281 , that, in accordance with that principle, the Member States must employ means which, whilst enabling them effectively to attain the objectives pursued by their domestic laws, cause the least possible detriment to the objectives and principles laid down by the relevant Community legislation.

[53] Accordingly, whilst it is legitimate for the measures adopted by the Member States to seek to preserve the rights of the public exchequer as effectively as possible, such measures must go no further than necessary for that purpose: see the *Molenheide* case, para 47, and *Customs and Excise Comrs v Federation of Technological Industries* (Case C-384/04) [2006] ECR I-4191 , para 30.

…

[58] Admittedly, the objective of preventing tax evasion sometimes justifies stringent requirements as regards suppliers' obligations. However, any sharing of the risk between the supplier and the tax authorities, following fraud committed by a third party, must be compatible with the principle of proportionality. Furthermore, rather than preventing tax evasion, a regime imposing the entire responsibility for the payment of VAT on suppliers, regardless of whether or not they were involved in the fraud, does not necessarily safeguard the harmonised VAT system from evasion and abuse by purchasers. The latter, were they exempted from all responsibility, could, in effect, be encouraged not to dispatch or not to transport the goods out of the member state of supply and not to declare the goods for VAT purposes in the envisaged Member States of destination.

61 By Article 273 of the VAT Directive, Member States are given a degree of autonomy in respect of additional measures adopted to ensure the correct collection of VAT. This article was considered in the context of the VAT default surcharge regime in *Enersys v HMRC* [2010] UKFTT 20 (TC), in which it was common ground, and accepted by the Tribunal, that a domestic measure providing for the enforcement of the VAT Directive must be proportionate (see paragraph 26).

62 Since then, on 21 June 2012, the European Court in *Mahageben* (C-80/11 and C-142/11) has confirmed this approach to be correct. Measures adopted under 273 must be proportionate:

[57] Furthermore, the measures which the Member States may adopt under Article 273 of Directive 2006/112, in order to ensure the correct levying and collection of the tax and to prevent evasion, must not go further than is necessary to attain such objectives. Therefore, they cannot be used in such a way that they would have the effect of systematically undermining the right to deduct VAT and, consequently, the neutrality of VAT, which is a fundamental principle of the common system of VAT (see, to that effect, inter alia, *Gabalfrisa and Others*, paragraph 52; *Halifax and Others*, paragraph 92;Case C-□□385/09 *Nidera Handelscompagnie* [2010] ECR I-□□0000, paragraph 49; and *Dankowski*, paragraph 37).

63 In *Enersys*, the argument of HMRC sought to draw a distinction between (i) the proportionality of the statutory provision as a whole and (ii) the proportionality of its application in a particular case, (in effect arguing that provided the regime as a whole was proportionate there was no need for it to be applied proportionately in a particular case). The Tribunal (Judge Bishopp) held that there was nothing of substance in such a distinction and that it is open to the Tribunal to consider whether the penalty in a particular case is proportionate, without first having concluded whether the regime as a whole is disproportionate (see paragraph 55).

64 There is no authority directly on paragraph 6A, but it follows from the above that directions made under paragraph 6A must be *proportionate* in an EU law sense. Paragraph 6A is a measure adopted to ensure correct collection of VAT under Article 273. It follows that it must be applied proportionately. HMRC's Guidance agrees with this proposition:

Notices of Direction must be used… proportionately…" (paragraph 3.1)

As with all HMRC powers, we are required to apply the power in a reasonable and proportionate manner" (paragraph 5.1).

The making of the Direction is a proportionate use of the power" (paragraph 7.1).

**3 appeal provisions**

65 The right of appeal against a Direction under paragraph 6A of Schedule 11 is given by section 83(1)(zza) and section 84(7B). They provide that the tribunal shall not allow the appeal unless it considers that HMRC could not reasonably have been satisfied that there were grounds for making the Direction, and that the Direction shall have effect pending the determination of the appeal

66 The First Tier Tribunal has the jurisdiction and indeed the duty to ensure that the principle of proportionality is respected. In *Enersys Holdings UK Limited* [2010] UKFTT 20 (TC) it was held that a penalty levied on the company under the default surcharge regime was disproportionate and was discharged. At [32] Judge Bishopp said:

…if the remedy is disproportionate to the aim, the court or tribunal has a Community duty to intervene.

67 In *Eco-Hygiene Limited v The commissioners for Her Majesty's Revenue and Customs* [2011] UKFTT 754 (TC) it was said:

[31] In our view, the correct approach is that … the Tribunal has not only jurisdiction, but a duty, to intervene if the Community principle of proportionality is infringed.

68 The Tribunal is concerned with the purpose and effect of the decision at issue, not (or not only) the purpose and effect of the regime at large, see *Oxbridge Research and HMRC* [2012] UKFTT 261 (TC) at 66, and the authorities considered therein at 63-65. Notably, here where the potential scope of directions which "*might* assist" is wide and a Direction has been made which is unlimited in time, particular care must be taken to ensure that the exercise of the power is not unreasonable and disproportionate. The Tribunal may allow or refuse the appeal. It does not appear that there is any power to vary the Direction or substitute an alternative Direction.

69 In summary, the law is that the officer making the Direction must *believe* that the test is met *upon grounds* that are known to him, and objectively reasonable. The test is that there are be taxable supplies in respect of which the VAT chargeable might not be paid, that the records specified in the Direction might assist in identifying those supplies and that it is proportionate in the sense required by the principles of EU law. Thus, the Direction must not go further than is necessary for the purpose of preserving the right of the Treasury to collect the tax, be the method least detrimental to the objectives and the principles laid down by the relevant Community legislation and not be used in such a way as to have the effect of systematically undermining the right to deduct VAT.

70 It is to be noted that paragraphs 3.1 and 5.1 of the Guidance correctly reflect the law in stating that a Direction must be made proportionately and that “the burden that compliance with the measure will place on the taxpayer concerned” is an important relevant consideration. The Guidance states that this should be balanced against “the seriousness of the risk (i.e. the likelihood and level of revenue risk in the particular case concerned) that the notice of Direction is designed to address”. This could be better articulated: there could be cases in which there is a huge risk of loss, but the Direction has little prospect of assisting in reducing the loss. The balancing consideration is better articulated as the likelihood that the Direction will assist in preventing tax loss.

71 Paragraph 5.1 correctly reflects the well-known principle of public law that each case must be decided on the merits. However, there is a tension between that paragraph and paragraph 4 which asserts that the business should be asked to keep a record, which includes the information specified in the Guidance, and provides a template letter. Deciding each case on its merits should apply not only to whether to make a Direction, but also the terms of any Direction made.

72 The prescriptive nature of paragraph 4 and the template encourages the reader to breach this principle and apply a Direction in rigid terms once the decision to make a Direction has been made. (The tension between these paragraphs of the Guidance is illustrated by the evidence of Mr Demand, who had blindly copied the template letter from the Guidance but claimed to have tailored it to the circumstances of the case).

73 The Guidance, at paragraph 6, prescribes a two stage process with a recommendation being made by the case officer and reviewed by the senior officer.

**4 submissions on the facts**

74 Mr Demand said that the note headed "Review of application for Notice of Direction to maintain additional records", dated 14 June 2011 contains the entirety of his reasoning in making the Direction. It states that "enquiries made by Jane Matthews, SI Colchester, have established that most of the deals carried out from March to November 2010 commence with a tax loss *from a fraud against the revenue*." (emphasis added)

75 In fact this over-stated the true state of affairs. Ms Matthews had only identified that the deals chains had originated with a tax loss, not that the loss was fraudulent, rather than due to honest default. The respondents did not assert fraud against the appellant or anyone else in the Statement of Case. Ms Matthews did not assert in her witness statement that the tax losses were fraudulent.

76 Yet Mr Demand claims that this is what her enquiries had established. It is regrettable that the evidence on this crucial aspect of the case should be unsatisfactory. It appears that Mr Demand has made the Direction on the erroneous and hence unreasonable ground that the identified tax losses had been identified as fraudulent.

77 Mr Demand made the Direction on the understanding that a director of the Company – Mr Mann - had previously been a director of Global Telecoms Ltd. In fact by the time of the Direction, Mr Mann had resigned and lodged his resignation with Companies House on 10 June 2011. Had Mr Demand checked the position before making his Direction on the basis of that fact, he could easily have avoided the error. This ground for making the Direction was not a reasonable ground, as it was false.

78 The respondents have sought to argue that the fact of Mr Mann being formerly a director could have been a reasonable ground in retrospect, but the Tribunal is concerned with the grounds in Mr Demand's mind at the time (see *O'Hara*), not those that could retrospectively be ascribed to him. In any event the fact that Mr Mann had ceased to be a Director was deeply significant in making a Direction as to what should happen in future at the business.

79 The status quo, as of June 2011, was full cooperation. Instead of imposing the Direction, the respondents could simply have asked for further assistance from the appellant. They could have continued to work together with the appellant to ensure that the appellant's deal chains were free from fraud. The respondents have called no evidence to suggest that cooperation would not have continued, or that it was necessary or proportionate to put the appellant at risk of further punishment by means of the Direction.

80 The evidence was that Ms Matthews had had "cooperation at all times" during her dealings with Demazda and she had never had any problem with [Mr Kotrofis] supplying paperwork in the past. The respondents have called no evidence to show that the Direction has in fact assisted since it was fully implemented in February 2012. The sole evidence in this regard is that after the Direction the provision of records is less satisfactory than before as all the communications are directed through the appellant's solicitors appointed for the purposes of this appeal, thereby introducing an element of delay.

81 The monthly sales analysis shown to the Tribunal had been provided by Demazda since Ms Matthews first asked for the information on 17 May 2010 and, extended the analysis on 9 February 2011. Ms Matthews said that the purpose of these was to "test the integrity of the deal chains". She confirmed in evidence that she had been able to do this as it was the basis for the deal sheets provided.

82 There is no contemporaneous record of how Mr Demand considered that the terms of the Direction might assist but in evidence says that the purpose is to identify the integrity of the deal chain this is exactly what Ms Matthews had achieved with the monthly sales analysis.

83 The list of information to be kept per unit of stock includes items which are required to be kept by all taxable persons under paragraph 6. In fact the whole of the list, except serial numbers and weight, are matters ordinarily recorded on the invoices which are required to be kept under regulation 31, and paragraph 6 of Schedule 11. There may be circumstances in which it is legitimate to make these items subject to a specific Direction under paragraph 6A on top of the general requirement under paragraph 6, however these will be rare. Where a person has been abiding by the requirements of paragraph 6 it is unnecessary to make them subject to an additional requirement to keep the same records that they are keeping in any event. (On the other hand, where a person has not been abiding by paragraph 6 it may be most appropriate to penalise them for that failure, rather than add a further requirement without enforcing the existing requirement).

84 All but the weight and serial numbers were already reliably being kept and provided by the appellant prior to the Direction being issued – though some fields such as date into stock, place of storage, date of release to customer are derivable from other documents kept in the deal packs. Counsel for the respondents agreed the analysis was materially correct during the appellant's opening.

85 It is apparent, though Mr Demand claimed strenuously that it was not so, that no consideration was given to the terms of the Direction. They were copied wholesale from the appendix to the Guidance, without regard to the circumstances of this particular appellant. The wording is identical between the two, save where the latter leaves a space for modifying the name of the taxable person and such like.

86 Mr Demand's evidence that he drafted the terms of the Direction and tailored them to the circumstances of the appellant is untrue. The terms had already been drafted and he simply copied them without regard for their content. This meant that there are references to a number of pieces of information which are obviously irrelevant: those which are not relevant to a business that trades back-to-back – such as stock reference; references to serial numbers on mobile phones and CPUs, which are not relevant to the appellant; references to an appeal being to the VAT and Duties Tribunal, when that body had been abolished long before the Direction in this case was made.

87 The fact that this was a wholesale copy of the template only became apparent during the course of the hearing, when the respondents provided the appellant with a copy of the Guidance. The fact that Mr Demand's claim that he was tailoring the Direction to the circumstances of the appellant is demonstrably untrue means that there is no satisfactory evidence as to Mr Demand's state of mind. The fact that the terms of the Direction were not considered in relation to the appellant means that if any of the requirements were appropriate it would be more a matter of luck than judgment. It may also explain why the Direction is poorly drafted and ambiguous.

88 Furthermore, there is no satisfactory evidence to suggest that he believed that the terms, or any particular term, of the Direction might assist, as he does not appear to have given the matter any thought. If follows from *Saik* and *O'Hara* that he did not believe upon reasonable grounds that any particular term was appropriate. This is borne out by the fact that the note headed "Review of application for Notice of Direction to maintain additional records", dated 14 June 2011 which Mr Demand said fully set out his reasoning for making the order makes no mention of any reason for including any particular term in the Notice.

89 The sole advantage of making a matter the subject of a Direction rather than an informal request of a taxable person is the possibility of enforcement action. Where a Direction is ambiguous such that it could not be enforced, it has no purpose and seeking by Direction to have a taxable person to do something which could not be enforced is disproportionate.

90 The Direction requires "A record that will show, for each unit of stock purchased, the following information: …. Weight…." This requirement is unclear: does it mean actual weight or nominal weight (i.e. the manufacturer's stated weight)? Does it mean gross packed weight or net weight? The most obvious and natural meaning of this requirement is the actual weight of an individual item. The respondents' Statement of Case assumes this to be the meaning, saying "it is self-evident that knowing the weight of a particular item can assist… etc." However we are told that this is not what was actually meant.

91 Mr Demand stated that it means "the gross palletized weight of the overall consignment of the particular volume of goods, and if the invoice involved different goods, the weight of any distinct class of goods". Mr Demand therefore said he disagreed with the author of the Statement of Case. (Though this was not something he raised at the time of seeing the Statement of Case before it was served.) No enforcement action could be taken for a failure to comply with the Direction as construed by Mr Demand. The respondents have not sought to justify any other interpretation of the weight requirement.

92 The Direction is ambiguous in other ways. It states that serial numbers are to be kept "or if appropriate batch and or lot numbers". Mr Demand said in evidence that he did not consider this to be ambiguous and it meant that serial numbers must be kept unless they did not exist or could only be obtained by opening the cartons. However, the ambiguity is apparent from his own letter of 27 June 2011 where he refers to clearing up an "ambiguity". In that letter he says it means that serial numbers must be kept for all goods where they exist. Mr Demand's own assertion that the Direction is not ambiguous is undermined by the fact that he has himself referred to it as ambiguous and he has ascribed it different meanings on different occasions.

93 Mr Demand claims in his witness statement that the Direction required a business to set up a stock record style format as in a second hand VAT scheme, but this is simply not the case. The Direction is silent as to format. The Direction seeks a record that will show the required information for each unit of stock purchased, but is entirely silent as to how this is done. The Monthly Sales Analysis was already providing this. The majority of the items on the list relate to lines of stock as opposed to individual items of stock. A requirement to keep serial numbers is different from a requirement to keep other information on the list because it relates to individual units of stock rather than lines of stock.

94 If the requirement to keep the information as a record "per unit of stock received" is read literally, it would require a record which repeats all the items in the list per unit of stock, with only the serial number changing from one record to another: e.g. the line on the 900 Lens kits require 900 identical records save for the serial number. What may really be meant by the list in paragraph 4.2 of the Guidance is a record of all the information about lines of stock, and separately a record of all the serial numbers which relate to each line of stock.

95 This is the approach that has been adopted by the appellant in this case by providing the monthly sales analysis record together with a separate list of serial numbers involved in each transaction. No complaint has ever been made about this approach, nor is it prohibited by the terms of the Direction.

96 The requirement to maintain Serial Numbers is of the greatest importance to the appellant, as the nature of its business involves supplying electronic goods on short timescales by identifying a supply to meet a particular demand. Any delay in the supply makes the appellant a less attractive trading partner, as other suppliers are likely to be able to provide the goods quicker. To facilitate speed, the appellant does not usually transport the goods to his own premises, but has them forwarded directly from the supplier to the purchaser. It is a style of operation which is typical of many of the smaller operators in the electronic goods supply business.

97 The serial numbers requirement is a particularly onerous one for a business which does not take physical custody of the goods and operates on the tight margins recorded on the sales analysis summary for March 2010 to June 2011 put in evidence. The companies supplied by the appellant in the months preceding the Direction were overwhelmingly large and well known retailers. Thus, there is no risk that the goods are non-existent or not as described, or the retailer would inevitably return the goods. As indeed had occurred where Play Stations had been returned by eBuyer on 27 June because they were faulty.

98 It is extremely unlikely that the trade in the goods forms part of a carousel or is otherwise contrived given (in particular) the presence of a large and well known retailer in the chain. The retailer inevitably takes physical possession of the goods and records serial numbers as part of its ordinary business process. There is no evidence (and no reasonable grounds to suppose) that goods traded by the appellant were ever otherwise than as described.

99 The evidence as to the utility of this requirement remains entirely speculative. There is no evidence of it having been of use to the respondents, in assisting them to identify tax loss, or indeed that it has been used for any purpose. Further and alternatively, there is no evidence that what was required was 100% of serial numbers for 100% of deals as opposed to a sample of serial numbers for each deal, or serial numbers for a numbers of deals in the first place to establish whether they really do assist the respondents. A move in the first place towards a sample of serial numbers may well have achieved the desired result (and was offered by the appellant).

100 It appears that Ms Matthews had in mind making a Direction requiring the business to keep EAN numbers rather than serial numbers. After a meeting at Demazda on 9 June 2011, she wrote:

EAN numbers are recorded on each deal which relates to the batch number, not the individual machines. Informed Costas that I will probably send a letter directing them to keep these numbers, he said they do already.

101 The ordinary reading of this is that at that time Ms Matthews was considering making a Direction as to EAN numbers as opposed to serial numbers.

102 Ms Matthews's evidence to the contrary was unsatisfactory: she said in evidence that the document in fact meant something else, that she had meant she would send a Direction requiring him to keep, not EAN numbers, but serial numbers, because she had already had a discussion with her line manager Mr Demand about whether to ask the business to keep serial numbers. It is submitted that the more natural reading of the document, is that all references relate to EAN numbers not serial numbers, is to be preferred.

103 The Guidance at 6.1 requires the recommendation on whether or not to make a Direction to be made by the case officer who has the most detailed knowledge of the circumstances of the business. It is significant that Ms Matthews the case officer was not even considering making a Direction as to serial numbers: she was the person with the most detailed knowledge of the business, and should, according to the Guidance, have been the one that should make the recommendation as to any Direction.

**5 conclusions for the taxpayer**

104 First, Mr Demand could not reasonably have been satisfied that there were grounds for making the Direction, and second, the Direction was disproportionate.

**For the Crown**

**The statutory test**

105 Paragraph 6 of schedule 11 of the Value Added Tax Act 1994, as amended, provides for a general requirement to keep records; paragraph 6A was an amendment made by the Finance Act 2006 section 21.[5]

106 It is submitted that section 84(7B) must be read compatibly with paragraph 6A(3), because otherwise the entitlement of the commissioners under paragraph 6A(3) to made a Direction, where *"they have reasonable grounds for believing that the records specified in the Direction might assist in identifying taxable*

[5] It has since been subject to minor amendments under the Finance Act 2008, schedule 37 paragraph 6.

*supplies in respect of which the VAT chargeable might not be paid"*, would be in potential conflict with a constraint arising out of section 84(7B) (could the commissioners *"reasonably have been satisfied that there were grounds for making the Direction"*).

107 Rather, paragraph 6A(3) and section 84(7B) must be construed as applying the same test: the issue of whether the commissioners could *"reasonably have been satisfied that there were grounds for making the Direction"* under section 84(7B) is to be determined solely by whether they had *"reasonable grounds for believing that the records specified in the Direction might assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid"*. To construe section 84(7B) otherwise would be to contradict paragraph 6A(3).

108 The requirements for such a Direction are therefore: (i) did the commissioners have reasonable grounds for believing that there may be taxable supplies in respect of which the VAT chargeable might not be paid? ('the tax loss point') and (ii) did the commissioners have reasonable grounds for believing that the records specified in the Direction might assist in identifying such potential tax loss? 'The potential assistance point').

109 The 'tax loss' limb is self-evidently a much lower threshold than the commissioners needing to establish to the civil standard of proof that there has already been fraudulent evasion of VAT. That is not the statutory test. There is no precedent fact to the commissioners' power to issue a paragraph 6A notice of having established on the balance of probabilities that there has been a fraudulent evasion of VAT in a deal chain leading to a transaction involving an appellant. Indeed, the 'tax loss' limb does not necessarily require any past tax loss at all, and can be satisfied *prospectively*, where there are reasonable grounds for believing there may in the future be taxable supplies in respect of which VAT might not be paid, irrespective of whether there have not to date been any such instances.

110 This is reflected in the commissioners' Guidance on power for HMRC to direct additional record–keeping requirements, which at 3.3 considers that a Direction may be made in respect of "*Newly-established businesses, with little or no trading history"*, where the intended pattern of trading has the characteristics of involvement in supply chains connected with MTIC fraud (*"These characteristics include trading in standard rated goods of significant value and volume, bought and sold on a 'back to back' basis. Consideration should also be given to whether the transactions, including the terms of payment, lack transparency and whether the business lacks substance in terms of fixed assets, staff employed etc."*).

111 It is further to be noted that (a) the express language of paragraph 6A(3) only refers to the possibility of tax loss (*"taxable supplies in respect of which the VAT chargeable might not be paid"*), and (b) it makes no mention at all of whether that potential tax loss may be due to fraud or otherwise. In short, the commissioners submit that the tax loss limb requires no more than whether there are reasonable

grounds for believing that there may be taxable supplies in respect of which the VAT chargeable might not be paid.

112 If the commissioners have reasonable grounds to believe that there have been significant past tax losses in transactions chains with which a business is involved, then that in turn is a reasonable ground for believing that there may be taxable supplies in the future linked to that business's transactions in respect of which the VAT chargeable might not be paid.

113 To hold otherwise would not only be contrary to the express words of the legislation, but also would frustrate the legislation's purpose: the Direction under 6A is to assist in identifying tax loss that might not be paid; it therefore serves a prospective, preventative purpose as well as potentially assisting where a tax loss actually eventuates; to limit the circumstances where a 6A Direction could be given to those where VAT fraud has already been established in the tribunal, for example, would hamstring the power.

**The tax loss point in the present case**

114 It is submitted that the tax loss limb is amply satisfied in the appellant's case. As set out in the notification of tax loss letter of 25 May 2011, the commissioners had reasonable grounds to consider that the 22 of the 33 transactions from 1 March 2010 to 30 November 2010 where the chain had been established commenced with a defaulting trader, resulting in a loss to the public revenue exceeding £945,219.

115 As Ms Matthews openly admitted in oral evidence, the basis for considering that there had been tax losses in each of these chains was the advice she had received from the HMRC officer responsible for investigating the defaulting company. Mr Demand seconded this evidence, explaining that the relevant officer carrying out the enquiries would have confirmed that a tax has not been declared, and that it was considered that the default was not due to commercial business failure, resulting in tax loss letters being written: in Mr Demand's words, *"we had established that the businesses were as far as we could reasonably determine missing traders or defaulting traders"*.

116 Ms Matthews and Mr Demand were entitled to rely upon such information for the present purposes, namely determining whether there were reasonable grounds for considering that there *may* in the future be tax losses in transaction chains involving the appellant that the information sought might assist in identifying. There was no need for the commissioners to wait for evidence to a greater standard, whether through appellate proceedings or prosecutions or otherwise, before considering that the tax loss limb was satisfied in the present case.

117 Furthermore, it is not necessary for the tax loss to arise in circumstances of possible 'carousel' fraud, i.e. where the transaction chain begins with an import

from the EC and ends with an export to the EC; 'acquisition' fraud can occur where tax chains are entirely domestic; the products are sold to consumers, but a trader higher up the chain defaults, leaving VAT unpaid. Notwithstanding this, in fact the commissioners had reasonable grounds to believe that many of the 22 transactions did start with an import from the EC, and that the majority of them ended with an export to the EC [R/67 to 108, and the oral evidence of Jane Matthews as to the same].

118 The appellant's arguments on the 'tax loss' limb seem to be limited to two submissions. The first is the assertion, without any proper evidence, that it was "*vanishingly unlikely*" that eBuyer or Dabs.com was involved in any contrived dealing, the implication being that there could therefore be no ground for a Direction against the appellant. As to this:

The appellant seems to have been under a misapprehension as to the nature of the transactions that eBuyer was involved in. Although described in its appeal, along with Dabs.com, as "solely retailers", in fact fifteen of the deal chains involved eBuyer selling the goods on to another business, not retailing them.

The fact that a company is a big and established company does not preclude the possibility that elements within that company might act improperly (otherwise there could never be rogue traders within established banks). Indeed, eBuyer's trading in this case seems at variance to its ordinary pattern of retail business, as the appellant understood it. Without making any adverse inference against eBuyer, it is nevertheless not open to the appellant to assert, still less for the Tribunal to accept, that the fact that eBuyer is an established company necessarily means there can be no possibility of a connection (inadvertent or otherwise) to fraudulent tax losses.

The commissioners had reasonable grounds to believe that 15 of the transaction chains in which the appellant supplied eBuyer involved a tax loss earlier in the chain.

The fact that the appellant may have traded with particular companies in the past does not mean it would necessarily continue to do so in the future.

119 The second argument would appear to assert that the goods supplied by the appellant were always as described, hence, it is implied, there can be no link to fraudulent tax losses. If this argument is being put forward, it is misconceived:

120 First, the appellant was not in a position to know whether the goods supplied are genuine goods, in circumstances where the only check upon them was upon the EAN which applies generically to a particular product, rather than being distinct to individual items produced by the manufacturer (as a serial number is). The fact that the box of a certain model of Sony Playstation 3 has the EAN number appropriate for that certain model does not make the goods necessarily genuine.

121 Second, tax losses can occur in respect of genuine goods, whether through acquisition fraud (where the goods are sold on to end consumers), carousel fraud or otherwise.

122 Third, much is made by the appellant of the fact that eBuyer did not, save in respect of a single instance in relation to 4 Playstations, return any goods, as evidence that they must have been as described. However, that seems largely predicated on the misconception that eBuyer was retailing the goods, when in fact the evidence suggests that they were in turn selling them on wholesale.

123 For these reasons, it is respectfully submitted that the Tribunal cannot properly find otherwise than that the commissioners had reasonable grounds for believing that there may be taxable supplies in respect of which the VAT chargeable might not be paid (the tax loss limb), that the records in question may assist in identifying (the potential assistance limb, addressed below).

**The potential assistance point**

124 The question is whether the commissioners have reasonable grounds for believing that the particular information sought might assist in identifying the taxable supplies in respect of which tax might not being paid. As to this, it is important to note the low threshold required under the legislation. Paragraph 6a(1) imposes no limitation at all on what records might be identified ("*such records as they specify in the Direction in relation to such goods as they so specify"*), and under paragraph 6a(3) the only limitation is that they "*might assist*". This is obviously distinct from, for example, a requirement that the records *will* assist, or *are likely to* assist.

125 It is common ground that the items listed in the Direction fall into three categories:

Serial numbers;

Weight;

The other information, which must be kept in any event.

126 As to the potential assistance of serial numbers to investigating potential fraud, Mr Demand set this out in his witness statement. In particular, serial numbers can assist in checking the integrity of the supply chain in a timely manner; they can assist in investigating the existence and authenticity of the goods, including by enabling enquiries to be made with manufacturers or distributors; and they can assist in understanding how the products originally entered the chain of supply, e.g. through checking with manufacturers , and by cross-checking with the NEMESIS database, which may indicate if some of the goods were being traded in a potential carousel. None of this evidence was

challenged in cross-examination, and the potential utility of serial numbers therefore stands unchallenged.

127 The appellant's only arguments in respect of serial numbers would appear in fact to be proportionality challenges, namely that the same information could be obtained from the appellant without a Direction at all, because the appellant would have co-operated voluntarily, and/or that the information could have been obtained from others in the supply chains, for example eBuyer.

128 In particular, the appellant seeks to suggest that its recording of serial numbers could not assist HMRC. This argument is self-evidently without merit. The suggestion that it would suffice for HMRC to seek serial numbers from "*the end purchasers of the goods*" is misconceived, likewise the suggestion that serial numbers might be obtained on importation: the potential utility of the Direction is that it may help track the supply of items through a deal chain, and validate the integrity of that chain. The appellant's argument presupposes the very integrity of the chain that the commissioners may seek to test.

129 Likewise, the evidence of Mr Demand as to the potential utility of knowing the claimed gross pallet weight for a transaction, also set out in paragraphs 15 to 19 of his witness statement, stands unchallenged, not being contested in cross-examination. The gross weight cited for the goods "*can assist by identifying consignments where the weight does not tally with the expected weight for the goods type and volume described and invoiced, or where the consignment could not have been transported as described as it was not possible to be moved by the method stated in the commercial documentation, due to weight and/or size restrictions*", and thereby undermine the alleged existence and/or authenticity of the goods purportedly being traded.

130 The appellant's only arguments in respect of weight go to the issue of the specificity of the Direction, which is a distinct question discussed below, and the attempt to rely on the fact that Mr Demand indicated, after the Direction was issued, that he was prepared to drop the requirement to obtain gross weight details if the other data set out in the Direction was kept. Mr Demand explained that offer in paragraph 20 of his witness statement, being a pragmatic offer, and it was not meant as, nor can it be seen as, a concession that weight could be of no potential utility, the only issue under the statutory test.

131 Paragraph 6A does not preclude the commissioners making a Direction requiring information that would be required in any event. If that information might assist in identifying taxable supplies in respect of which the VAT might not be paid, the commissioners can include it under paragraph 6a. Moreover, the inclusion of such records in a paragraph 6A Direction does have some additional effect, because the Direction requires that these other items are provided *along with the weight and serial numbers.*

132 The utility of both weight and serial numbers will depend in large part upon the commissioners' ability to tie such information to particular transactions – hence the necessity to have all the information requested in the Direction in a single record for each line of stock traded. As Mr Demand explained, whilst most of the items need to be held by the appellant under existing VAT Regulations, a business is not required to keep them in a stock record style of format, unless the business is operating a second hand VAT scheme (which the appellant was not). Having information presented by stock record assists in identifying taxable supplies in respect of which VAT might not be paid, because of the ease with which transactions can be traced back and enquiries made. Again, this evidence was not challenged in cross-examination.

133 The potential assistance of the other items in the Direction, in addition to serial numbers and weight, can be easily seen if the hypothetical example of a Direction that required only serial numbers and weight to be kept. A list of serial numbers on their own is self-evidently of limited assistance – such information needs to be seen alongside all the other details of the relevant transactions, such as the supplier, supplier's invoice date, net purchase value; customer and so on. With serial numbers alone, it would not be possible, or only with a great deal of time and effort, to relate the information provided with the other data in relation to those transactions. Hence the obvious potential utility of the Direction in requiring a record of all this information, by stock line, alongside the serial numbers and gross weight.

134 For these reasons, it is respectfully submitted that the records specified in the Direction might assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid, and indeed that the commissioners' evidence on this has largely been left unchallenged by the appellant.

**The Mr Mann point**

135 It is unclear whether the appellant maintains its apparent challenge on the basis that the Direction observed, as a reason for issuing the Direction, that "*a director of the company was previously a director of a business where significant tax losses from fraud were identified by HMRC and notified to that business*". Certainly, counsel for the appellant did not place much emphasis upon it in oral opening. It is respectfully submitted that he was right not to do so, as the appeal cannot succeed on this point.

136 As at the date of making the Direction, 14 June 2011, the observation that Mr Mann was a director was entirely reasonable. Only five days previously, on 9 June 2011, Ms Matthews had been informed on a visit to the appellant that Mr Mann was a director. It was only on 16 June 2011, after the Direction was issued, that Mr Benali emailed Jane Matthews to state "*both Jim and I have decided to step down as Directors of Demazda International with immediate effect*", which suggests that Mr Mann stepped down as at that date, 16 June 2011 (similarly, on 4

July 2011, Mr Kotrofis stated in a telephone call that "*Jim and Chris have resigned. He was not sure of the exact date but he thought it was last week*").

137 Even if the commissioners had already been informed that Mr Mann was no longer a director, that fact would not preclude the reasonableness of considering that his having been a director was relevant to the question of whether additional records from the appellant's business might assist in the identification of tax losses. Mr Mann was previously a director of Global Telecoms, and significant tax losses were identified by HMRC in relation to transactions with which Global Telecoms were involved, which led to a notification of Global Telecoms. The Direction letter does not state that Global Telecoms knew or should have known that its transactions were connected with the fraudulent evasion of VAT. In *Emblaze Mobility* it was accepted that there had been fraudulent default, at [189].

138 The commissioners were entitled to take into account the involvement of a director in a previous business whose transactions were linked to fraudulent evasion of VAT in deciding to make a Direction under para 6A, just as under para 6A(4) the power to make that Direction exists in respect of a business whose transactions are linked to VAT loss does not involve any implication that that business is itself involved in the fraud. It was not unreasonable to consider that the involvement of a director who had previously been involved in a business whose transactions linked to VAT losses was of relevance to the question of whether additional records from the appellant's business might assist in the identification of tax losses. There is no necessary implication of the knowledge of Mr Mann himself in any fraud.

139 Even if (which is not admitted) the fact that Mr Mann had been a director of Global Telecoms was not itself a reasonable ground for believing that the records specified in the Direction might assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid, as the commissioners did have other reasonable grounds for so believing, an appeal against the Direction on the Mr Mann point must fail.

**The proportionality challenge**

140 The commissioners accept that Tribunal has jurisdiction to consider the proportionality of the Direction, on the basis that it derives from article 273 of Directive 2006/112. This provides "*Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion...*", and as found in *Enersys* [26] "*It was common ground that a domestic measure providing for the enforcement of a Community obligation... must be proportionate*".

141 There would appear to be several strands to the appellant's proportionality challenge:

there was no need for a Direction at all, because the appellant would have provided the information voluntarily, given its history of co-operation ('the co-operation point');

there was no need for a Direction in respect of serial numbers, because the information could have been obtained from others in the supply chain, such as eBuyer ('the alternative source point';

the requirement to obtain the serial numbers of the goods it trades is "*an unduly onerous, costly and time consuming requirement to place on a broker*" ('the burden point').

**The co-operation point**

142 There is something surreal in the appellant's seeming contention that the Direction was disproportionate because until issuing it the appellant had co-operated with HMRC's demands. This argument would appear predicated on a suggestion that the appellant would have voluntarily provided all the information requested in the Direction, which is in stark contradiction to the fact of having brought this appeal against the Direction, including on the basis that it cannot comply with the serial number requirement.

143 Mr Demand was entitled to take the view that it was preferable for HMRC to ask the appellant to keep the relevant records on a regulatory basis, by way of the Direction, and his opinion that once businesses are advised of a significant level of tax loss, there is a risk of the withdrawal of cooperation provided previously was borne out in this case: rather than complying with the Direction, the appellant has sought to appeal it. It cannot properly be argued in these circumstances that the Direction was disproportionate because the appellant would have provided all the same information voluntarily. Even if the appellant would have provided all the information voluntarily, then there is no disproportion to the Direction, because it makes no difference: the appellant would be providing the information either way.

**The alternative source point**

144 The appellant seeks to suggest that its recording of serial numbers could not assist HMRC, because it would suffice for HMRC to seek serial numbers from "*the end purchasers of the goods*". This argument is self-evidently without merit, and is not established on the evidence. The potential utility of the Direction is that it may help track the supply of items through a deal chain, and validate the integrity of that chain. The appellant's argument presupposes the very integrity of the chain that the commissioners may seek to test. In any case, the appellant has not demonstrated as a matter of fact that all those companies to whom it supplies goods take the serial numbers of the same – the suggestion, for example, that eBuyer takes the serial numbers would seem linked to the misconception that

eBuyer is retailing the goods to individuals, rather than selling them on in back to back transactions.

**The burden point**

145 The appellant's chief argument on proportionality is that requiring it to keep serial numbers of the goods it trades is *"an unduly onerous, costly and time consuming requirement"*. The commissioners submit that that question falls to be answered upon consideration of:

(i) The obvious and weighty public interest in the identification and prevention of VAT fraud. In the present case, 22 of those 33 transactions in the nine month period of 1 March 2010 to 30 November 2010 where a deal chain was established commenced with a defaulting trader, resulting in a loss to the public revenue of almost £1 million (£945,219). The potential scale of tax loss is bigger even than this, and falls in the context of the estimated tax loss due to VAT fraud at the time being between £1 billion and £2.5 billion (oral evidence of Mr Demand).

(ii) The likely burden to a businesses in general (rather than this appellant in particular) of compliance with the Direction. Mr Kotrofis' own evidence was that customers retain records of serial numbers as part of their ordinary business process, and that serial numbers would be on the documentation when the products left the manufacturers (although this was qualified in re-examination by saying that "I don't know [that] 100%"). Further, his evidence was that the serial numbers were either provided by the supplier free of charge, or it had to pay the freight forwarder to record the serial numbers, at a cost of 6 pence per unit.

146 In the light of all this evidence, it is submitted that a requirement to keep serial numbers is not in general a particularly onerous one, and certainly not disproportionate to the public interest in identifying and preventing VAT fraud in cases where there are reasonable grounds to make a paragraph 6A Direction.

147 The fact that businesses are already under extensive obligations to keep records, and are liable to assurance visits and other action taken under the wide powers of the commissioners to enforce compliance, even where there is no particular risk of tax loss. The additional records required under the Direction are therefore an increment to the existing regulatory requirements given the particular risks identified; if the existing requirements are proportionate in the generality, where there is no particular risk of a tax loss, it is submitted that the threshold for the additional records required under paragraph 6A to become disproportionate, where there are reasonable grounds for believing that these may assist in identifying a potential tax loss, must be very high.

148 The commissioners repeat their submissions that the impact on a particular business of a Direction that it is otherwise entitled to make under paragraph 6A should not be considered in the assessment of proportionality.

149 First, complying with regulatory requirements is an inevitable cost of running a business. If the profits generated by a business are too slender to enable it to meet regulatory requirements which are otherwise reasonable, then that is the fault of the business, rather than the regulatory requirements. It cannot be the case that a business which is not very profitable is not obliged to adhere to a regulatory requirement, whereas businesses that are profitable, are so obliged. In the context of directions under 6A, it cannot be the position that companies can escape requirements for additional directions which the commissioners have reasonable grounds for considering would assist in identifying tax fraud by asserting that they are insufficiently profitable to do so.

150 Likewise, it cannot properly be a consideration under proportionality that the appellant has structured its business as a broker which never takes physical control of the goods, rendering (it claims) the process of identifying serial numbers more time-consuming / expensive, in particular when the problem of VAT fraud is prevalent in precisely such circumstances. As Mr Demand stated in his letter of 27 June 2011 "*due to the tax fraud risk that has been established in the company's trade, we are concerned that the risk of fraud in the transactions will continue due to the way the transactions take place, particularly while the goods are held in a third party premises that you do not have day to day control over. Over the last 10 or so years, we have established that there is a risk where goods are traded this way, that the products are not as specified on the invoices or order notes."*

151 In a similar way, the appellant's reasoning that its suppliers are concerned about opening outer cartons is itself of concern, because this is another indicator of the goods being used in multiple MTIC fraud, as "*To the fraudster, the opening of the outer carton makes them undesirable for subsequent use, as the tax and border authorities will take an interest in subsequent shipments of the cartons."* In short, it cannot be a relevant factor *against* the proportionality of the Direction that the appellant has structured its business in a way that makes it more likely that its transactions are linked with VAT fraud.

152 Even if the appellant's arguments in relation to its circumstances did fall to be considered in the consideration of proportionality, at their highest they would be self-negating. The very aspects relied upon as grounds for showing the extent of the burden upon the appellant (slim profit margins, never taking possession of the goods, not keeping serial numbers itself) are aspects which commensurately increase the public interest in applying the Direction in the appellant's case, being the very aspects that make it more likely that tax fraud may be identified by the Direction. In short, the commissioners respectfully submit that a business cannot evade keeping records that may assist in identifying VAT fraud by reliance on the very aspects of the way it structures its business that make it more likely that its transactions may be linked to tax fraud.

153 In any case, as a matter of fact it is denied that it would be unduly onerous to record serial numbers in Demazda's particular case. As already noted above, Mr

Kotrofis' evidence was that since seeking to comply with the Direction in February 2012, the serial numbers have either been provided for free by suppliers, or by the freight forwarder at a cost of 6 pence per unit. Mr Kotrofis repeated this cost per unit twice, so there can be no doubt about it, giving the example of 6 pence in the context of a 25 pence gross profit in the sale of hard drives.

154 Consistent with this, Mr Kotrofis' evidence of his company "suffering since June 2011" is not credible, and in fact there is evidence that his business' turnover is not substantially effected on a like for like comparison. Demazda only started attempting to comply with the serial number requirement in February 2012 (initially wanting interim relief, before HMRC confirming that the Tribunal does not have power to grant it; since February 2012, the appellant's turnover for the quarter March, April and May has in fact been similar to that in the same quarter in the previous two years (Ms Matthews' oral evidence, which Mr Kotrofis did not contradict).

155 Further, it is further denied that it was reasonably evident at the time of making the Direction that it would be overly onerous. For example, on 9 June 2011, Mr Kotrofis represented to HMRC that Demazda was already going to the warehouse in person to check the stock, and already recording and keeping EAN (European Article Number) numbers from the batches.

*The decision making process*

156 In the appellant's cross-examination of Mr Demand, in respect of the HMRC Guidance, counsel for the appellant appeared to make several criticisms:

that contrary to paragraph 6.1 of the guidance, the recommendation on whether or not to make a Direction had not been made by Ms Matthews;

that paragraph 3.3 of the guidance set as a 'condition precedent' to making the Direction that a director had previously been involved in a transaction chain commencing with a tax loss, yet Mr Mann was no longer a director;

that Mr Demand had not looked at the appellant's case 'on its own merits' as required under paragraph 5.1.

157 First, it is not accepted that the Tribunal has any jurisdiction to consider these, as potential basis for allowing the appeal. They are discrete points from the statutory test as to reasonable grounds discussed above, and to proportionality. Any challenge for the failure to comply with HMRC internal guidance would in effect be a public law challenge which should be brought by way of judicial review (see *The Master and Fellows of St Mary Magdalene College in the University of Cambridge v Revenue & Customs* [2011] UKFTT 680 (TC), [43]:

In our view we do not have the jurisdiction to consider legitimate expectation issues. Our jurisdiction is prescribed by section 83 VATA. The language used in

that section cannot, we think, be extended so as to enable this Tribunal to consider HMRC's conduct and review whether HMRC are precluded from collecting tax which is due as a matter of tax law.

158 Second, in any event there is nothing of substance in these criticisms. Whether or not the recommendation to make the Direction had originated with Ms Matthews, or arose through discussion with Ms Matthews and Mr Demand, the Guidance is clear that the senior officer, Mr Demand, has the ultimate responsibility for taking the decision as to whether or not reasonable grounds exist for the Direction, and there is no question that he took that decision in this case. The matter of who made the initial recommendation is therefore immaterial.

159 The suggestion that there is a 'condition precedent' in 3.3 of the Guidance that a director had previously been involved in a transaction chain commencing with a significant tax loss is misconceived: paragraph 3.3 states *"There must be evidence that the business or one or more of its key personnel..."*, the 'or' clearly putting the fact of a key personnel's prior involvement in the alternative. In the present case, there were reasonable grounds to consider that the appellant had been involved in transaction chains commencing with a significant tax loss – indeed, the commissioners had reason to believe that 22 of the chains did so.

160 The suggestion that Mr Demand did not consider the particular facts of this case because the Direction was drafted in similar terms to previous Directions and along the lines of the draft Direction in the annex to the Guidance, is based on a false premise, namely that a Direction will necessarily be different for one company to another, if the circumstances of each company are considered.

161 In fact, as Mr Demand explained, he did consider the circumstances of the case, and in particular the fact that the appellant was trading electronic goods in deals where the transactions were between multiple wholesalers, back to back, with no stock being held, and he was entitled to conclude that the requirements adopted in other cases with materially similar circumstances were appropriate in this case.

**The specificity of the Direction**

162 The appellant has sought to criticise the ambiguity and lack of specificity of the Direction, in particular in relation to the serial number and weight requirements, cited in the Direction.

163 Looking at the list of information required, it is self-evident that by *"A record that will show, for each unit of stock purchased, the following information"*, the commissioners were referring to the need for the information for each particular line of stock (i.e. any distinct class of goods on an invoice). Although the phrase *"for each unit of stock"* is used, the fact that *"quantity"* is demanded obviously indicates that the information being sought is not for each individual item (otherwise 'quantity' would always be '1'); likewise, the fact that *"unique serial*

*numbers of individual items"* are sought is in clear contradistinction to the rest of the items listed, the corollary being that those are not for 'individual items' but rather for each line of stock held.

164 As to weight, Mr Demand stated that what was intended by "*weight*" was *"the gross palletised weight, if it was on a pallet, of the overall consignment of a particular volume of goods, i.e. the weight of any distinct class of goods on the invoice"*. Yet although the Direction does not set that out in terms, that what was sought was the gross weight of the line of stock was evident from the Direction when considered as a whole and in the context of normal business dealing.

165 As submitted above, 'weight' is listed as a unitary demand along with 'quantity' and every item listed other than *"unique serial numbers of individual items"*. It follows by necessary implication that the 'weight' referred to is the gross weight of each stock line;

166 In ordinary commercial dealings, the gross weight of a transaction is recorded in commercial movement records (as, for example, in the Global Freight Systems invoice provided in the appellant's disclosure at [AS/94]).

167 The appellant readily understood the requirement as being for the gross palletised weight of a transaction, on 21 June 2011 Mr Kotrofis advising Mr Demand: *"He advised that he would have some difficulty in obtaining one of the items specified, which was the gross weight of each pallet."* Given that there was in fact no real issue between the parties as to the 'weight' requirement, any lack of specificity on the face of the Direction should not preclude its being a lawful Direction, and the appellant has not in fact articulated the basis on which the appeal could be allowed for any such ambiguity.

168 Similarly, while criticisms may be made of the wording in respect of serial numbers, the intended meaning of the request is clear: *"or if appropriate"* is in contradistinction to *"where they exist"*, Mr Demand explaining that the intention behind "if appropriate" being "if the serial numbers don't exist", although he allowed that there may be rare cases where the serial numbers are not visible on the outside packaging, such that the serial numbers could not be obtained without commercial damage to the individual product (this is distinct from the packaging to cartons carrying a number of products).

169 However, that electronic products invariably carry the serial numbers on the outside of their boxes, in the generality the Direction is clear: if they exist, the serial numbers of the individual products must be provided. This is underlined by the further reference *"or in the case of mobile phones unique IMEI numbers"*, suggesting that there is no alternative in those instances to the individual IMEI numbers because they exist (i.e. the '*if appropriate batch and/or lot numbers'* will never apply).

170 It is therefore submitted that the information required by the Direction was clear, when its demands are read in context and with common sense, and that any ambiguities are not such as to invalidate it. The appellant had the opportunity to clarify any areas of doubt as to the requirements of the Direction with HMRC, which in effect renders any lack of specificity on its face materially insignificant.

**8 Conclusion**

171 For these reasons, it cannot properly be said that the commissioners "*could not reasonably have been satisfied that there were grounds for making the Direction*". On the contrary it is submitted that the power under 6A was designed precisely for cases such as the present. Further, there is no basis for finding that the Direction is anything but a proportionate measure to identify and prevent potential tax loss. In these circumstances, it is respectfully submitted that this appeal must fail.

**The Tribunal's Conclusions**

**1 The extent of the appeal jurisdiction**

172 It is clear that the Tribunal in these circumstances possesses only such jurisdiction as the statute confers and that it is not empowered to exercise a jurisdiction akin to a judicial review. If the commissioners' decision making process was characterised by failures, such as taking into account misconceptions as to the true facts of the case, it does not of necessity follow that the appeal must succeed.

173 We are required to address only the question whether the commissioners "could not reasonably have been satisfied that there were grounds for making the Direction"; if they could reasonably have been so satisfied, the fact that their decision making process was in other respects open to criticism is a matter for another jurisdiction. That that result may prevent the appellant from having the matter tested in all respects as to its legality in this appeal is the consequence of the narrow terms in which parliament has defined our jurisdiction.

174 A corollary of that conclusion is that the tests of the commissioners' state of mind proposed by Mr Yeo for the taxpayer on the basis of the House of Lords' rulings in *O'Hara* and *Saik* are not relevant in this appeal. The criterion specified in the narrow jurisdiction accorded the Tribunal excludes a decision on the basis of what the commissioners did believe (although the evidence as to that is clearly part of the overall picture) and requires an objective analysis of what the commissioners *could* reasonably have been satisfied as to.

175 There are two clarifications, however, that must be added.

176 The first is that it is established - and is common ground between the parties - that the Tribunal must take into account the principle of proportionality in

Community law when construing the commissioners' powers. The national legislation is to be considered in the light of that doctrine as it has been elaborated by the Court of Justice. We return to that question below.

177 The second is with regard to what Mr Donmall for the Crown has submitted is an apparent conflict or mismatch between section 84(7B) and paragraph 6A. In essence this point is that the criterion of the commissioners' having "reasonable grounds for believing that the records specified in the Direction might assist" etc. could be seen as distinct from the test to be applied by the Tribunal that they "could not reasonably have been satisfied that there were grounds for making the Direction". It would, as Mr Donmall submits, be unlikely that parliament has imposed on the commissioners one basis upon which they could act and then assigned to the appellate body an inconsistent basis upon which to judge that action.

178 In fact, we see no difference of substance between the two criteria, but only two different ways of addressing the same core issue. Thus, the reasonable satisfaction of the commissioners that there were "grounds for making the Direction", which the Tribunal must consider, refers not to the existence or otherwise of reasons at large which might justify a Direction but to the existence of the precise criterion stated in paragraph 6A, that "the records specified in the Direction might assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid". That is the question the Tribunal has to answer.

**2 Proportionality in law**

179 The issue has been raised in this appeal whether the Community law doctrine of proportionality, which it is agreed binds the Tribunal, should be considered in relation to the contested powers of the commissioners in general terms, or whether it should be examined in the particular context of this case. Thus it is argued that what may be acceptable in terms of the Community law doctrine in principle may, in the circumstances of Demazda's business, fall foul of it.

180 To propose such a dilemma may be to envisage a false dichotomy. The rule of Community law reaffirmed by the Court of Justice in *Teleos* is that –

[52] …, as regards the principle of proportionality, it must be recalled that the court held, in para 46 of its judgment in the *Molenheide* case [1997] ECR I-7281, that, in accordance with that principle, the Member States must employ means which, whilst enabling them effectively to attain the objectives pursued by their domestic laws, cause the least possible detriment to the objectives and principles laid down by the relevant Community legislation.

[53] Accordingly, whilst it is legitimate for the measures adopted by the Member States to seek to preserve the rights of the public exchequer as effectively as

possible, such measures must go no further than necessary for that purpose: see the *Molenheide* case, para 47, and *Customs and Excise Comrs v Federation of Technological Industries* (Case C-384/04) [2006] ECR I-4191 , para 30.

181 It is thus a rule which cannot exist independently of the circumstances in which the contested powers are to be exercised. There must be a context in which the issue of proportionality arises and there cannot therefore be either compliance with, or a breach of, that principle in the abstract. A similar question has been considered several times at first instance in the context of the default surcharge regime, at length, in *Enersys Holding UK Limited v CRC* [2010] UKFTT 20 (TC) at [55] to [57], Judge Bishopp concluding (at [57]) –

I remain unpersuaded that there is anything offensive in testing an individual penalty even when the regime itself is, on the whole, acceptable.

182 This conclusion was followed in *Eco-Hygiene limited v CRC* [2011] UKFTT 754 (TC), at [40], and again in *Oxbridge Research Group Ltd v CRC* [2012] UKFTT 261 (TC), the Tribunal saying, at [66] –

In our judgment, it is open to the Tribunal to consider the proportionality of the surcharge [...] independently of whether the surcharge regime as a whole complies with the principle of proportionality.

183 The facts of each case must therefore be considered, but considered in the context of the legislation which has established the contested powers, its evident purpose and the gravity of the mischief it seeks to remedy. That context is very well known, and we are entitled here to take judicial notice of the fact that trade of the appellant's type has for many years been associated with a very substantial risk to the integrity of the public revenue, and with infiltration by organised crime. This consideration was most recently recognised by the Court of Justice in *Mahageben* in these terms –

[55] Moreover, in accordance with the first paragraph of Article 273 of Directive 2006/112, Member States may impose obligations, other than those provided for by that directive, if they consider such obligations necessary to ensure the correct levying and collection of VAT and to prevent evasion.

184 The extract from the judgment of the Court of Justice in *Mahageben* cited by Mr Yeo emphasises that the possible mischief in nationally imposed restrictive measures would be in "systematically undermining the right to deduct VAT", which cannot be said to be the effect of the use of the commissioners' powers under paragraph 6A.

185 The explanation of why the additional record-keeping would assist HMRC in tracking the chain of transactions to search out those which are not commercially authentic is entirely convincing – checks with the original equipment manufacturer, with import and export records, and obviously with the information

held by HMRC in the course of tax administration generally. Putting the tax authorities in a position to undertake this work is all the more necessary in view of the very limited scope which it is known that 'due diligence' enquiries by traders provide for ascertaining useful or accurate information.

186 The powers in paragraph 6A have existed since 2006 without, until now, any challenge to their proportionality whereas it is common knowledge that, though its volume fluctuates over time, MTIC fraud in its various forms continues to be an important concern. While Mr Yeo has argued strongly that there is no evidence, at any rate in this case, that the information sought from Demazda has been of use in combating tax fraud and has urged that less intrusive measures would suffice, it must be recalled that the burden of showing that a provision falls foul of the Community doctrine of proportionality rests on the taxpayer.

187 In general terms, at least, that burden has not been discharged, and indeed the taxpayer has not particularly sought to discharge it. We have little difficulty therefore in concluding that the paragraph 6A powers do not themselves infringe the principle of proportionality. What of their application to this individual case, however?

**3 Proportionality in practice**

188 At the hearing of the appeal, evidence was introduced about the effect the Direction had had in practice since it had been fully complied with in February 2012, and various other matters emerging since June 2011. In principle, we do not see this hindsight evidence as relevant to the task of examining the circumstances in which the Direction was made and we do not therefore refer to it; to do so, would be to exceed the Tribunal's jurisdiction in reviewing the Direction itself at the time it was made.

189 Before the date of the Direction, Demazda was supplying all the information required by it with the exception of the details of serial numbers and weights. The obscurity of the Direction with regard to these two matters is addressed below, but on the assumption that the Direction referred to individual serial numbers it is evident that it would have been possible to obtain the information needed from suppliers at no cost, or freight forwarders at the cost of 6 pence per item. On 10 June, Mr Kotrofis had informed officer Matthews that he indeed went himself to the warehouse to record the EAN batch numbers, and he could therefore have used these visits to ascertain serial numbers.

190 For these reasons, it was plainly possible for Demazda to supply individual serial numbers to HMRC, even without the use of the scanner which the company purchased, and the only question that remains is whether the expense of doing so was disproportionate to the objective.

191 On that, although the use of freight forwarders to report serial numbers might have been significantly expensive and in some cases prohibitively so, the facts we have found indicate that the exercise could have been accomplished at the modest effort of adding information routinely obtainable from commercial sources, or from visits to freight forwarders, to the monthly schedules already being prepared. It is true that the evidence also showed that certain suppliers would not cooperate in supplying serial numbers, which would reduce the number of possible transactions for Demazda – though that in itself suggests a question mark over the commercial authenticity of the suppliers in question.

192 Against this, the evidence is that there was a very serious problem associated with Demazda's trade - though of course not necessarily one which was Demazda's fault: HMRC's tax loss letter of 25 May 2011 indicated that of 33 transactions 22 were connected with tax losses amounting to almost a million pounds. Whether those losses were connected with fraud or not, a matter which we address below, there is clear evidence of a major threat to the revenue associated with the appellant's trading and the bar of showing that supplying the information required was out of proportion to the mischief occurring is thus a high one.

193 While in principle it may be possible for the exercise of the powers in paragraph 6A to be so demanding that the conduct of legitimate business is virtually prevented, and while there is no doubt that compliance with the Direction would mean some loss of profitability, it cannot be concluded in the circumstances of this case that the requirement to record individual serial numbers was disproportionate to the objective authorised by Directive 2006/112 of ensuring the correct levying and collection of the tax and of preventing evasion. Nor did the Direction have an impact on the right of the taxpayer to deduct input tax, a constant concern appearing in the decisions of the Court of Justice.

194 The argument on behalf of the appellant that the commissioners could and should have invited its cooperation, rather than imposing a Direction with severe penalties attached, remains under this heading. It is essentially a contention that in invoking statutory powers instead of relying upon a continuation of the admitted cooperation which Demazda had afforded them, the commissioners' action was an excessive and unnecessary and therefore a disproportionate use their powers.

195 While it may be the case that the same result could have been attained by voluntary means – as to which we make no finding - it does not follow that recourse to a Direction was disproportionate: if action undertaken voluntarily was reasonably required and would have been undertaken, it cannot be said that the same action required under legal powers breached the principle of proportionality. Nor can it be said that the commissioners should have sought information from other taxpayers better placed to bear the burden of providing it: to do so would be

to enter into speculation about the circumstances of other traders who are not before the Tribunal, and of whose affairs there is no relevant evidence before us.

196 It should be added that the appellant's contention, that no useful result has been shown from the collection by HMRC of the required data, cannot be accepted. The Crown evidence has shown that there is at least a reasonable likelihood that the information sought will be useful in combating tax loss, and a breach of the principle of proportionality is not demonstrated by the absence of specific proof that the exercise has shown results. In the nature of such matters, the utility of the Direction may be related to taxpayers other than the appellant, or may become apparent in the affairs of other traders which HMRC are not at liberty to divulge.

197 The conclusions we have reached with regard to the reporting of individual serial numbers hold good equally in regard to the reporting of weight, at least in the terms clarified by Mr Demand in his evidence to us.

**4 The relevance of fraud**

198 It has been seen that both Ms Matthews and Mr Demand believed that the tax loss cases identified with Demazda's trading were characterised by fraud, when in fact that perception was not based on actual evidence. Mr Demand in particular recorded on 14 June that "most of the deals carried out from March to November 2010 commence with a tax loss from a fraud against the revenue". Mr Yeo has argued strongly that this error means that the commissioners' Direction was based upon a belief which did not justify it.

199 It is however correct, as Mr Donmall has submitted, that in order to be entitled to exercise their powers under paragraph 6A the commissioners do not need to have any belief with regard to the presence or absence of tax fraud, but merely to have reasonable grounds for believing that the keeping of the specified records might assist in identifying taxable supplies in respect of which the VAT chargeable might not be paid. The commissioners could properly entertain such a belief without there being any question of tax fraud being present, and it follows therefore that a belief stronger than that required by the statute must encompass one which would have been lesser.

200 Erroneous as the officers' beliefs were in this regard, the relevant question for the Tribunal remains whether the commissioners "could not reasonably have been satisfied" that there were grounds for making the Direction. We have already indicated that we consider that there was a basis on which the commissioners could reasonably have been satisfied, namely the very strong connection in Demazda's trading with transactions involving tax loss, and the consequent need to intensify the surveillance of the course of business in question. The revenue was plainly at risk and the commissioners were entitled to take steps to minimise that risk.

## 5 The directorship of Mr Mann

201 As in the case of his belief in the presence of tax fraud, Mr Demand's belief that Mr Mann was a director of Demazda when the Direction was made was mistaken. It is not enough, as Mr Donmall has urged, to say that the assumption of Mr Mann's directorship was in effect a reasonable mistake to make and that there were – post 14 June – further indications that Mr Mann had not resigned at the time of the Direction. When exercising legal powers exposing taxpayers to severe penalties in the event of non-compliance, strict attention must be paid to publically available official information and that was not done. The error was compounded by the mistaken assertion – and it can only be read as such – that Mr Mann had been a director of a company itself involved in tax fraud.

202 Nonetheless, in this case also, the officer's errors do not avail the appellant because the commissioners already had grounds upon which they could reasonably have been satisfied that the Direction should be made on account of the multiple cases in which Demazda's transactions had been found to be connected with tax loss. And, notwithstanding Mr Mann's resignation as a director, his (albeit innocent) previous involvement in a similar situation was a relevant consideration. Again, a belief that he held a more important position than he actually did encompasses a reasonable belief that Mr Mann might have a lesser, but still pertinent, role in Demazda's affairs; the commissioners could reasonably have been satisfied on that account that there were grounds for making the Direction.

## 6 Specificity of the direction

203 The issues we have considered up to this point are examined on the assumption that the Direction made cannot be impugned in regard to its detailed terms. We have already concluded that the appeal jurisdiction defined by section 84(7B) does not entitle the Tribunal to undertake any examination of the commissioners' internal proceedings akin to a judicial review. On the contrary, the appeal jurisdiction is framed in terms which are designed to confine an appeal to the severely practical purpose of reviewing the Direction in the light of the facts which actually existed, rather than permitting a review of the legal or administrative adequacy of the procedures adopted.

204 It cannot be correct, however, that the Tribunal should ignore the terms in which a Direction has been made. To do so, would be to achieve the improbable result that a Direction may be found to be unimpeachable in circumstances in which it is ambiguous, uncertain, and in practical terms unenforceable. As we have seen, the ambiguities in the Direction in relation to serial numbers and weight had to be the subject of subsequent discussion and 'clarification'.

205 In particular, the specification of the records as to weight was, on the Crown's own evidence, defective because it required individual items to be weighed when the intention was that batches or groups of items should be

weighed; and it was not stated in the Direction whether the weight of the items should be recorded with or without taking into account the weight of their packing or containers.

206 The same was true with respect to serial numbers: in the circumstances of Ms Matthews's control visit four days before the Direction was issued and the communication with Demazda that then passed, it was especially important to be quite clear about what was required of the company; the admitted ambiguity had to be resolved by Mr Demand in his letter of 27 June 2011.

207 A Direction of this kind is a formal administrative act adopted under statutory powers and is not part of a continuing correspondence with the taxpayer. The Direction is either effectively made at the point of issue, or it is not, and the fact that it has required the ingenious arguments put forward by Mr Donmall to try and rescue it from its uncertainties speaks for itself. It cannot be said that in issuing a Direction, whose principal purpose was to bring details of the serial numbers and the weight of goods within the reporting regime, in terms which were ambiguous and uncertain the commissioners could reasonably have been satisfied that there were grounds for making the actual Direction which they did make.

208 As we have made clear, the commissioners could reasonably have been satisfied that there were grounds for making *a* Direction in the terms which Mr Demand apparently intended, but we cannot see that they could have been so satisfied in relation to *the* Direction actually made on 14 June 2011. The appeal must therefore succeed.

**7 Further appeal rights**

209 This document contains the 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 no 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.

**MALACHY CORNWELL-KELLY**
**TRIBUNAL JUDGE**

**RELEASE DATE: 9 October 2012**