[2012] UKFTT 744 (TC)

TC02404

Appeal Numbers: LON/2007/1937 & LON/2007/1938

Value Added Tax - MTIC appeal by two closely-related companies that had clearly traded in the legitimate grey market in mobile phones - whether various deals effected in the months of April, May and July 2006 that had been traced to fraudulent losses of VAT were deals where the Appellants knew or ought to have known that their transactions were connected to such fraudulent losses - Appeals dismissed

FIRST-TIER
TAX CHAMBER

GSM EXPORT (UK) LIMITED ("in Administration")

-and-

SPRINT CELLULAR DIVISION LIMITED ("in Administration")
Appellants

-and-

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

Tribunal: JUDGE HOWARD M. NOWLAN
ELIZABETH BRIDGE

Sitting in public at 45 Bedford Square in London from 9 to 31 August 2012

Andrew Trollope Q.C. and Leon Kazakos, counsel, on behalf of the Appellants

Jeremy Benson Q.C., Robert Wastell and Maria Roche, counsel, on behalf of the Respondents

DECISION

Introduction

1. These were two Appeals by closely related companies where the Appellants appealed against the denials of input tax repayments by HMRC in relation to 17 deals in mobile phones effected by one or other Appellant in the months of April, May and July 2006. 10 deals were effected in April, all involving purchases from a company referred to as Worldtech, with all the supplies being to a Greek company referred to as Cellaway. Three deals were effected in May and four in July.

2. We were told that other appeals by the same companies were standing behind these appeals, though we were told nothing about those appeals related we presumed to other and later transactions in mobile phones. The total input tax in dispute in respect of the 17 deals that were the subject of these two appeals was £5,291,780.

3. In this Decision we will refer to the two Appellants together as “the Appellants”, to GSM Export (UK) Limited in isolation as “GSM”, and to Sprint Cellular Division Limited as “Sprint”.

4. This Appeal was certainly not unique, but it was nevertheless slightly unusual in that it was undisputed and obvious that the Appellants had both been trading in quite legitimate grey market transactions. This trading usually took the form of competing in auctions for large quantities of “tail-end” stock being sold by companies such as Tesco, Argos, 02 and other similar household-name companies. Certainly in the case of one Tesco sale, details of which we were shown, it was clear that any purchasers of the auctioned lots of stock had to inspect the stock before tendering for it if they wished to inspect it; they then had to pay before collecting; and the purchaser was required to furnish evidence that the purchased mobile phones had subsequently been sold either to Africa or the Far East. The presumed reason for this was to prevent the purchasers competing with Tesco in its endeavour to sell the remainder of the particular models of phone through its UK stores.

5. The disputed deals effected in April, May and July 2006 were eventually conceded to have been traced to fraudulent VAT losses. The essential contention on behalf of the Appellants, implicit in the evidence of Mr. Andrew Payne (“Mr. Payne”) (a director of both Appellants, a small shareholder in Sprint, and the 100% shareholder in GSM) was that when the Appellants had manifestly been engaged in *bona fide* trading for years, when Mr. Payne had never before been accused of any form of dishonesty, and when Mr. Payne asserted that all purchases had been made from suppliers that Sprint had known for roughly ten years, and that Sprint regarded as entirely reliable (such that due diligence was rather pointless), it was plain that the Appellants had neither known or had any occasion to know that their transactions were connected to the frauds. Furthermore, it was contended by the Appellants’ counsel that, on account of these circumstances, a very high burden of proof was incumbent on the Respondents before we should conclude that the Appellants knew, or ought to have known, that their transactions were connected to fraud.

6. We did not doubt that Sprint had dealt with the two suppliers (namely companies that were referred to, and that we will refer to as "Worldtech" and "Lexus Telecom") that had supplied the mobile phones in 16 of the 17 transactions, on many occasions in the past and that both companies had very likely undertaken legitimate transactions with the Appellants. We also accept that the third supplier (a company that we will refer to as "Devi Communications") had been known to a Mr. Sellers who had at the time worked for the Appellants, and that a long-established *bona fide* connection was asserted between Devi Communications and Mr. Seller's former employer.

7. The evidence presented to us, much of which may not have been known to Mr. Payne at the relevant time, certainly established that Mr. Payne's faith in his suppliers (if it was genuine) was on all 17 occasions misplaced. Not only were all the transactions traced to fraudulent VAT losses, but each of the suppliers (except Devi Communications) was found to be making the fixed relatively small margins common amongst "buffer companies" in MTIC chains that were inconsistent with open market negotiation of sales prices. Furthermore, in the case of Worldtech, there were several factors that we will mention below that made it quite clear that Worldtech was a significant participant in MTIC transactions. In the case of the Devi Communications deal, it emerged (and it was in reality obvious at the time) that Sprint's supplier and customer were associated companies.

8. We accept that most of the facts just referred to might not have been known to the Appellants at the time of the contested transactions. The difficult question that still fell to us was whether we should accept, at face value, the evidence of Mr. Payne that the Appellants' did have unquestioned faith in their three suppliers, and therefore confidence that all the supplies made to the Appellants would be legitimate, or whether we should conclude that Mr. Payne's protestations of faith in his suppliers were suspect, or that on any other basis we should conclude that the Appellants knew, or ought to have known, of the connection of their deals to fraudulent VAT losses.

9. Our conclusion was that the facts in relation to the 10 transactions in April with Worldtech, coupled with the facts in relation to a considerable number of transactions with Worldtech effected on 28 and 29 March 2006, were inconsistent with *bona fide* transactions and that Mr. Payne, and thus both Appellants, must in fact have known that these deals were connected to fraudulent VAT losses. It follows that in many respects we did not accept Mr. Payne's evidence. Beyond, thus, making it clear that we considered that Mr. Payne must simply have lied, we considered his evidence to be unsatisfactory in other ways. He often claimed to have forgotten important matters, or to be very vague about important facts. His oral evidence often conflicted with the evidence given in his witness statements, and accounts during the oral evidence varied as well. We were left with the impression that on the astonishingly few occasions when some important transaction document actually indicated some trading terms, those terms were said not to represent the real deal because something different had been agreed orally.

10. We had some hesitation in relation to the May and July transactions but have ultimately reached the conclusion in relation to them that the Appellants either knew or ought to have known of the same connection. We are in part influenced by the prior conclusion that the April transactions must have involved actual knowledge of their connection to fraud, but will of course summarise in due course the other reasons

why we reach our conclusions in relation to the seven transactions effected in May and July 2006.

The evidence

Officer Chambers

11. The main evidence on behalf of the Respondents was given by Officer Chambers ("Mr. Chambers"). Virtually none of his evidence was questioned by counsel for the Appellants, save for the evidence in relation to one alleged error made by HMRC which we will refer to in paragraphs 134-138 below. We regarded that isolated topic as irrelevant, so that virtually all of Mr. Chambers' evidence is best reflected in summarising the facts in more detail below.

Evidence about defaulters

12. Evidence was given on behalf of the Respondents by Officer Lam in relation to the alleged defaulter in the chains of transactions leading to all ten of the April 2006 deals which involved sales to both Sprint and GSM by Worldtech. Almost all of the examination in chief of this witness, and then the cross-examination, related to questions concerning the rather doubtful standing and conduct of the freight forwarders that dealt with the goods involved in the ten chains in the April transactions. Once the Appellants' counsel ascertained that no suggestion was to be made by the Respondents that the evidence in relation to the freight forwarders was going to lead to any contention by the Respondents that the Appellants actually knew the identity of the defaulter in all ten April transactions, this line of cross-examination was dropped. The Appellants' counsel then confirmed that it was accepted that all the tracing of transactions in all 17 deal chains to the defaulters was correct, and it was also accepted that the first of the UK parties in the deal chains had been not only a defaulter (generally on a vast scale) but a fraudulent defaulter.

13. This acceptance on behalf of the Appellants rendered further questioning of Officer Lam irrelevant. Furthermore, whilst officers dealing with the other alleged defaulters in the May and July chains had furnished witness statements, the acceptance that the tracing to fraudulent VAT losses was not to be challenged rendered it unnecessary for these witnesses to give evidence in person.

Evidence in relation to Worldtech

14. Evidence was given on behalf of the Respondents by Officer Stuart McCaskell in relation to Worldtech. This evidence was straightforward and not disputed. While Worldtech had been trading for many years, seemingly in legitimate grey market trading of mobile phones, the evidence indicated that since 2001 Worldtech had been repaid approximately £24 million VAT in respect of export transactions, albeit that there was no claim in relation to these earlier transactions that the exports had been traced to fraudulent VAT losses. In March and April 2006, however, Worldtech had effected a number of UK to UK deals and 13 broker deals in which it had been an exporter. HMRC refused Worldtech's claim for VAT repayments for these periods of £13 million on the basis that all the deals were eventually said to have

been traced to fraudulent VAT losses. Apparently Worldtech did not appeal against these decisions.

Evidence about the loan agreement of 29 March 2006

15. Evidence was given on behalf of the Respondents by Mr. David Leach, an accountant, to the effect that a loan made to Sprint by Worldtech on 28 and 29 March 2009 was on unusual and un-commercial terms. We will in due course refer to the terms of the relevant loan, but for present purposes we simply say that we felt perfectly able to reach our own conclusion in relation to the terms of the relevant loan without any benefit of expert evidence.

The First Curacao International Bank ("FCIB") evidence

16. Very material FCIB evidence was given by Mr. Farmer. We will refer to all that evidence in due course, but we do feel it appropriate at this stage to thank and compliment Mr. Farmer for his astonishing work in preparing the FCIB evidence. It is daunting to see the amount of research and evidence that HMRC have to undertake in MTIC cases, and particularly the work required to try to understand and explain the evidence derived from the Dutch and Paris servers of FCIB. On this particular occasion we both considered that Mr. Farmer should be congratulated for his work.

Evidence about legitimate grey market trading

17. Numerous witness statements were provided by Mr. Fletcher of KPMG and Mr. Nigel Attenborough (called by the Respondents and Appellants respectively), and both witnesses were examined and cross-examined in relation to their best judgment of the likely "ceiling" levels of legitimate grey market trading in mobile phones. We will refer shortly to this evidence below, but consider that this evidence is only of any real relevance to the deals in April 2006, all of which involved one of two models of Nokia phone. In that regard, we considered the evidence to be reasonably clear, albeit that it merely supported and fortified conclusions reached largely on other grounds as regards the April transactions.

The Appellants' evidence

18. The only evidence given on behalf of the Appellants, save for that of Mr. Attenborough just referred to, was that given by Mr.Payne, and his sister, Louise Payne.

Louise Payne's evidence

19. It seemed that Louise Payne's role was to keep the books, and to deal at an administrative level with the paperwork, in other words the filing of the limited due diligence material, Redhill communications etc., and to deal (again on an administrative basis) with sending out purchase orders, invoices and instructions to freight forwarders etc. She claimed, and we accept, that she did not negotiate any of the deals and that she just implemented the deals negotiated and agreed by Mr. Payne. She did say that all of the deals were arranged by Mr. Payne. While it was always made clear that the then employee, Mr. Sellers, had had some involvement with the

May deal involving Devi Communications, no mention was made initially by either Louise Payne or by Mr. Payne that others (somebody called Belinda) might have had some involvement with the July deals involving companies that were referred to as Naam Electronics and Sotodelia, but we will refer to this issue in due course.

Mr. Payne's evidence

20. We have already indicated that we regarded Mr. Payne's evidence with considerable caution.

The facts in more detail

Background in relation to the two Appellants

21. Sprint was formed in 1997, its principal shareholder and director was then a Mr. George Webb, and the company's trade recorded in its VAT registration was that of the retail and wholesale of mobile phones. Although Mr. Webb remained the principal shareholder at the time of the contested transactions and whilst HMRC were conducting their enquiries, and he remained a director and presumably the majority shareholder throughout, Mr. Webb was never present or involved in any way in HMRC's enquiries, or (so far as we were aware) present at the hearing.

22. In October 2002, Mr. Payne started to work for Sprint and he was eventually given 5% or 10% of the share capital. In 2003, it seems that Mr. Webb and Mr. Payne agreed that a new company, GSM, which appeared to have been formed in 2001, should be activated, this company being wholly owned by Mr. Payne. The asserted intentions were that Sprint should continue the domestic trade, whilst GSM would endeavour to build up international trading, particular on the internet, in mobile phones. In January 2003 Mr. Payne was appointed a Director of GSM and Louise Payne was appointed as Company Secretary, and GSM was first registered for VAT purposes. Mr. Payne appears at all times (certainly since 2003) to have owned all the shares in GSM. In 2004, Mr. Payne was appointed as a director of Sprint. Whether it was then that he acquired his small shareholding in Sprint we are unclear but it is of no particular relevance.

23. It seems that nothing much came of the idea of conducting different lines of business through Sprint and GSM, if indeed it ever was the original intention. By the time of the contested deals the pattern that had emerged was that when back-to-back wholesale deals were undertaken, those deals might be undertaken by either company. Mr. Payne confirmed that in order to allocate profits appropriately between the company in which he had only the small shareholding and the one in which he held all the shares, if a loan was taken, say, by Sprint, it would often be followed by an appropriate on-loan to GSM, so that both companies could then undertake some of the deals. The two companies accordingly appeared to be trading (from the perspective of director control) as if they were one company, and profit-sharing or rather deal-allocation arrangements were made between the two companies so as to achieve whatever was thought to be the proper profit-sharing ratios. HMRC seemed to have been right when they asserted that they treated the two companies effectively as one. Certainly each participated in all the deals with which we are concerned in a similar manner.

24. We might mention in passing that the Respondents contended that GSM had been set up so that the Appellants would have two different companies to be making VAT repayment claims, so minimising the level of claim that either would make. This might have been a consequence of the activation of GSM, and little hinges on this. It appears equally likely that GSM was activated so that by arranging for some of the deals to be undertaken by GSM, Mr. Payne could thereby derive a significant share of the overall profits, without Sprint's original controlling shareholder having to sell or give away a substantial percentage of the shares of that company (possibly with capital gains tax implications). Furthermore the way the two companies operated together did give the shareholders total flexibility as to how to split the hoped-for profits between them.

An outline of the remaining evidence, and the format of this decision

25. Little evidence was given about those deals where the Appellants were plainly involved in legitimate grey market trading. We were told that during the periods in dispute in these Appeals the level of that trading was of only about 5% of the total trading turnover, but we were given no further information about these deals other than the brief summary recorded in paragraph 4 above.

26. The rest of the evidence breaks down into:

- evidence that we consider to be highly material in relation to deals undertaken between Worldtech, the Appellants and the Greek company, Cellaway, on 28 and 29 March, albeit that these deals were not the subject of the Appeals (paragraphs 32 to 47 below);
- evidence in relation to the ten deals in April involving those same parties (paragraphs 48 to 96 below);
- evidence in relation to each of the remaining seven deals, three effected in May and four in July 2007. The facts in relation to these were more varied and we will deal with those deals in relation to the four separate sets of facts involved.
- The deal in relation to the Devi Communications in May, which we have already referred to, is given in paragraphs 98 to 103 below.
- The deals in May where in one Sprint and in the other GSM bought from a company referred to as Lexus Telecom and sold to a company referred to as Cetro Tek Holdings are given in paragraphs 104 to 110 below.
- Two deals in July (one for Sprint and one for GSM) involved further purchases from Lexus Telecom and supplies to a Dubai company referred to as Naam Electronics, and are given in paragraphs 111to 114 below.
- Finally the facts in relation to two deals, also in July, by Sprint, involving purchases again from Lexus Telecom and supplies to a Spanish company referred to as Sotodelia Investments, are dealt with in paragraphs 115 and 116 below.

27. Following the summary of the evidence and the facts, the remainder of this decision will take the form that:

- In paragraph 117, we will summarise the contentions on behalf of the Respondents.
- In paragraph 118, we will summarise the contentions on behalf of the Appellants.

28. In paragraphs 119 to 128, we will commence our decision by dealing with two legal issues. The first is to deal with some arguments, particularly on behalf of the Respondents, geared to the proper application of the *Kittel* test and the correct interpretation of Lord Justice Moses' decision in *Mobilx,* [2010] STC 1436. The second legal issue addresses the standard of proof required by the Respondents to sustain their case.

29. We will then deal generally with two contentions advanced on behalf of the Appellants, namely the proposition that they derived confidence in their dealings from earlier acceptance of their transactions by HMRC (paragraphs 129 to 138). Secondly we will reject the suggestion that the Respondents need to show that the Appellants were aware of the detail of the fraud or for instance that the Respondents needed to demonstrate that the Appellants were aware of the identity of the fraudster.

30. More specifically we will then give our observations on the March transactions with Worldtech and Cellaway, and our decision in relation to all ten April deals, presently in dispute, involving those same companies (paragraphs 141-154).

31. We will then deal with some general observations in relation to the remaining deals (155-160) and the May and July deals in the slightly odd order of first the Devi Communication deal (paragraphs 161-165), then the Sotodelia deals (paragraph 166), then the two deals involving Naam Electronics and the two in relation to Cetro Tek Holdings (paragraphs 167 to 170 and 171 to 178).

The further facts in relation to the March 2006 deals

32. In March 2006, Sprint effected three deals in buying mobile phones from Worldtech, on-selling the phones to the Greek company, Cellaway. GSM effected one similar deal. All were undertaken on either 28 or 29 March. These deals were not challenged by HMRC, though HMRC did assert much later that they had eventually traced all the Appellants' purchases from Worldtech in March to fraudulent VAT losses. The deals are, however, highly relevant in relation to these Appeals.

33. The most significant fact in relation to the March deals was that Worldtech advanced £1,000,000 to Sprint on 28 March and a further £500,000 on 29 March, and on 29 March Worldtech and Sprint entered into a loan agreement for the £1.5 million loan. The terms of this agreement were that it was to be repaid at the end of a 28-day period; for that 28-day period "a fee of interest of 35%"(in other words £525,000) was to be paid, and if there was any delay in repaying the loan, penalty interest at the rate of 2% a day, calculated on a compound basis, was to be paid.

34. It is worth considering the simple maths in relation to the four March deals.

35. As with any export deal, the VAT-exclusive invoice prices charged by the Appellants to the foreign customer were likely to be, and indeed were, lower than the VAT-inclusive invoice prices payable by the Appellants to their UK supplier, so that the exporter was going to suffer a cash shortfall on effecting the export transaction until HMRC repaid the input VAT included in the supplier's VAT-inclusive invoices.

36. Ignoring the irrelevant allocation between the two Appellants, the VAT being reclaimed in respect of the March deals was of approximately £3,035,000, and assuming the recovery of that VAT the two Appellants would make profits of approximately £1,579,500 (ignoring the fee or interest charge mentioned in paragraph 33 above). The immediate cash shortfall that the Appellants would therefore suffer, pending the recovery of the VAT, would be the missing VAT, minus the profit margin (£3,035,000 minus £1,579,500) or approximately £1,455,500. They either therefore needed funding for the short period pending the hoped-for recovery of the VAT in an amount of very nearly exactly £1.5 million, or they needed to find an extraordinarily compliant supplier who would give credit and only expect to receive the last £1.5 million of its invoices prices when, or rather more relevantly **only if and when** HMRC refunded the Appellants their reclaimed VAT.

37. In the March deals it is obvious that the £1.5 million loan was precisely what the Appellants needed to bridge their VAT-gap. They needed something else, however, because they certainly needed implicit credit for the much more significant element of the invoice prices owing to Worldtech until their own customer, Cellaway, had paid them the slightly lesser VAT-exclusive invoice prices owed by Cellaway.

38. Since the invoice payments were all conveniently channelled through FCIB, we are able to see not only that the Appellants only in fact paid the amounts they owed to Worldtech **after** they had received their slightly lesser payments from Cellaway (topping up each payment by adding a bit of the monies just borrowed) but we happen also to see that all the payments rotated round in circles. The two obvious conclusions drawn from this are that, in addition to funding the Appellants' VAT-gap on the March deals by lending the £1.5 million, Worldtech also gave the implicit credit of only receiving the major element of invoice prices after Cellaway had first paid the Appellants. Furthermore the payments circulated very efficiently through eight companies involved in the invoice chain, back to the defaulter and through two foreign companies in the hidden parts of the chain where invoices were obviously not available to HMRC. One particularly swift rotation of payments through the eight companies took 42 minutes, though once the cash had reverted to its starting point, three minutes later it commenced another rotation and beat the record, returning to the starting point after 36 minutes. Such rotations obviously suggested pre-arrangement and knowledge of that by all parties in the chains.

39. The claimed expertise of the grey market trader is to have its trading contacts and it always aims to keep these contacts confidential or else others will cut it out of deals and thereby maximise their own profits. Quite how contacts might remain confidential when details were all exhibited on the International Phone Traders' ("IPT") website is difficult to say, but at any rate in late March neither Appellant had heard of Cellaway, and it was Cellaway that contacted the Appellants, seeking the categories and volume of phones that Worldtech happened to have available. While Sprint claimed to have had a long-standing relationship with Worldtech, and in

particular the director of Worldtech (Mr. Moses Oyediwura ("Moses")) the facts of which Mr. Payne and Sprint may have been unaware in late March 2006 were that:

- Worldtech had already exported directly to Cellaway itself;
- Cellaway had only been first registered to trade in February 2006; and
- It was Moses of Worldtech, and Moses in his capacity as the director of another company who had vouched for Cellaway when Cellaway had needed sponsors in order to open its FCIB account in January 2006.

There were further facts of which neither Mr. Payne nor anyone else could have been aware in late March 2006. These were that HMRC would in due course reject Worldtech's own input recovery claims in respect of mobile phone exports in March and April 2006 and, as we have mentioned, Worldtech chose not to appeal.

40. We draw three conclusions from the facts given above. Firstly it is perfectly obvious that Worldtech put everything on a plate for the Appellants, and without the Worldtech loan and the invoice price credit, the Appellants could not have effected transactions that potentially generated a post-interest profit of more than £1 million. Even more obviously since Worldtech knew far more about Cellaway than the Appellants did, and as it was Worldtech that apparently had the finance to fund the Appellants' March VAT-gap, Worldtech could itself have effected the March Cellaway deals itself.

41. There is no need for us to reach any conclusion as to whether Mr. Payne might have realised that the funding from Worldtech was too good to be true, and no need to give much thought to the significance of the fact that the Appellants figured efficiently in the speedy rotations of invoice payments through the FCIB accounts (indicating manifest pre-arrangement of when monies would be paid, and that some mastermind must have planned the payment rotations). It does however seem that these facts indicate that the mastermind must have made it certain that the Appellants would source from Worldtech and supply to Cellaway.

42. The firm conclusion that we are inclined to reach in relation to the March deals (all of which HMRC claimed eventually to have traced to fraudulent VAT losses; in all of which the Appellants duly recovered their reclaimed VAT, and in none of which did HMRC seek to recover the VAT subsequently) was that the Appellants were extremely lucky.

The denial of some of GSM's March 2006 input tax claim

43. There is little relevance to this point but we might mention that HMRC did refuse to refund a relatively small proportion of GSM's March VAT reclaim because HMRC contended that one of the non-Worldtech transactions involved a deal in phones that had not yet been released to the market, such that their very existence was in doubt. GSM claimed that it had in fact bought the relevant phones and that these phones had been some pre-production models issued to, and then sold by, a company that they claimed to be an authorised distributor. Whether or not this was so was never established because Mr. Payne said that they failed to obtain supporting information from the supplier, and therefore, either because the particular refused

claim was relatively modest or because they were out of time to appeal against the refusal of the input claim, they did not appeal.

The evidence in relation to the £1.5 million March loan

44. Before turning to the April Worldtech deals that are the subject of this Appeal, we need to refer to some of the evidence given in relation to the Worldtech loan made on 28 and 29 March 2006.

45. We should first record that there had been at least one prior occasion when Worldtech had advanced money to Sprint to finance one of the plainly legitimate grey market deals undertaken by Sprint. Mr. Payne also claimed that on several occasions Worldtech had either advanced other loans or given Sprint credit, and that the usual credit terms were that Sprint paid 2 ½ % interest a month on such borrowings. Neither the loans nor the extension of credit appeared originally to have been documented in any way, and we were given little detail about these claimed earlier loans.

46. We were told various things about the terms of the March 29 loan agreement. In his witness statement, Mr. Payne had said that the interest rate had been set at a high level to induce Sprint to repay it promptly. In oral evidence he said that the loan was only documented because HMRC officers had indicated that any loans ought to be documented. Accordingly he had suggested to Worldtech that the loan should be documented, and it was then Moses who had provided the loan agreement with the 35% interest rate for the 28-day period and the 2% compound daily penalty interest rate for any late repayment. When Mr. Payne had complained to Moses that the interest charge was “steep”, he was apparently told that the loan agreement was simply Worldtech’s standard form, and that Moses “would sort this out”. Whether or not this meant that the interest rate agreed in writing was not meant to apply was not made clear, though Mr. Payne certainly asserted in oral evidence that this was his understanding.

47. We will defer summarising what eventually happened in relation to the repayment of the principal of the loan, and the non-payment of all or much of the interest when we have summarised the facts in relation to the April Worldtech deals.

The April deals with Worldtech

48. In April 2006, Sprint and GSM effected 10 deals in all 10 of which Worldtech was the supplier, and the customer was again the Greek company, Cellaway.

49. Sprint effected seven of those ten deals, and so those deals were referred to as Sprint 1, Sprint 2 etc. GSM effected the remaining three deals referred to in a similar way. Two of the deals, Sprint 1 and GSM 1, were effected on 25 April. The remaining deals, Sprint 2 to 7 and GSM 2 and 3, were effected on 28 April.

50. The deal in Sprint 1, and all three of GSM’s deals involved the purchase and sale, in total, of 28,000 Nokia 8801 phones. The remainder of the April deals were in Nokia 8800 phones, the aggregate quantity sold in all the remaining six deals being 34,000 Nokia 8800 phones.

The broad detail of the chains in the April transactions, the respective unit margins made by each party in the chains, and the aggregate and percentage figures of profit made by the two Appellants in the ten April deals

51. It is irrelevant to give the detail of the trading chains in the ten April deals, and sufficient to say that the parties in all ten deals between the EU supplier to the defaulter ("United Traders"), the defaulter ("West 1"), two intermediate buffer companies, the immediate supplier to the Appellants (i.e. Worldtech) and the EU customer (Cellaway) were always the same.

52. The unit mark-ups made by each party in the chains prior to the Appellants appeared clearly to be pre-arranged margins, indicating that they were not negotiated in any genuine grey-market trading transactions. The unit profits made (according to the invoices) were 25p a unit for the defaulter and the first buffer, 50p a unit for the second buffer, and £1 a unit for Worldtech. The respective Appellants made unit profits in the range of £47 to £50, representing a profit margin of between 10.13% and 10.80%. According to the tracing of money movements in the FCIB accounts, Cellaway made a unit profit of 50p on its own subsequent sale of each phone.

53. In aggregate, and assuming a recovery of VAT, the Appellants' profits for the deals all undertaken on the two days of 25 and 28 April, were £3,000,050. The VAT reclaims for the April trading, ignoring small amounts that were conceded in respect of manifestly genuine trading and overhead expenses, were for £3,898,300 in the case of Sprint and £1,141,700 in the case of GSM.

Identification of the Appellants' supplier and customer for the April deals and other facts known about Worldtech (not necessarily known to Mr. Payne)

54 Mr. Payne claimed, and we saw no reason to doubt this, that Sprint had known and traded with Worldtech for 10 years; that he knew Worldtech's director, Moses, very well and that in view of this long connection it was superfluous to undertake due diligence in relation to Worldtech.

55. We accept that it appeared that Worldtech had had dealings with Sprint for some time, and clearly prior to the March 2006 deals. We observe that Mr. Payne himself had not worked for Sprint until late 2002 so that his own personal knowledge of Moses and Worldtech could hardly have been for the mentioned 10-year period but it did certainly appear that prior to 2006 Worldtech had financed Sprint's purchase of phones from an entity such as Tesco. Mr. Payne said that the verbally agreed terms for such finance were usually 2 or 2 ½ % a month. It also sounded as if there had been either several loans to finance purchases from companies such as Tesco, or occasions when credit had been given, but the detail of this was not given.

56. Leaving aside the claimed long-standing relationship said to exist between Worldtech and Sprint, we turn now to evidence given by HMRC, much of which almost certainly emerged only after the April 2006 period, and all of which might have been unknown to the Appellants.

57. As we indicated in dealing with the March transactions, it later emerged that Worldtech had undertaken numerous export deals in phones, all of which in March and April 2006 HMRC claimed to have traced to fraudulent VAT losses. When Worldtech's input recovery claims were disputed, Worldtech had chosen not to appeal. In addition, and again the Appellants may not have known this, the mark-up made by Worldtech in relation to every phone sold to either of the Appellants in the April 2006 period, and the mark-ups made by the earlier buffers were always of fixed identical amounts, Worldtech's own mark-up always being of £1. These facts appear to make it extremely likely that Worldtech was itself a participant in MTIC transactions, and at least not always the trader of unblemished repute claimed by Mr. Payne.

58. The next material fact revealed by HMRC was that Worldtech had lent money to other traders in mobile phones, though little detail was given of this.

59. The final material fact (albeit one again quite possibly not known to Mr. Payne, who claimed that the Appellants' March trading with Cellaway resulted from Cellaway having identified the Appellants as possible trade partners, possibly through the IPT web-site), was that Worldtech had clearly known of Cellaway before the March and April deals since, as mentioned above, Worldtech and Moses had supported Cellaway's application for an FCIB account in January 2006 even before Cellaway's first transaction in February 2006.

The Appellants' due diligence in general and in relation to Cellaway

60. We attach little importance to due diligence, save where facts actually revealed by it pose obvious questions. Generally however, when the fraudsters have been distanced from the broker or exporter by some mastermind by the insertion of a string of buffer companies that will inevitably have accounted for their VAT on their thin margins, due diligence generally proves of no assistance in testing the knowledge and means of knowledge issue in MTIC appeals.

61. In general terms, however, Mr. Payne did make some curious and conflicting remarks about his approach to due diligence. He certainly accepted that he was aware in general terms of the existence and essence of MTIC fraud. In his witness statement he claimed that the Appellants took their *"obligation to exercise reasonable diligence in combating against the fraudulent evasion of VAT very seriously"*, and also contended that *"we have done almost everything possible to guard against any of the transactions being tainted with MTIC fraud".* In reality, however, it seems that as a quite deliberate decision the Appellants attached little importance to due diligence. They claimed, certainly a good point if it was true and correct, that they preferred to rely, as regards their suppliers, on their own judgment of the integrity of their suppliers particularly when they had had long-standing relationships with those suppliers. As regards customers, it was asserted that there was no need to do any checks on customers as the customers only got the goods after they had paid for them.

62. Against those general observations, we note that the Appellants did receive by fax various documents from Cellaway on 28 March, immediately before conducting the deals on 28 and 29 March, or quite possibly after issuing the paperwork for the deals on 28 March. Most were in Greek and they provided no particularly relevant

information. Slightly more significantly, at about lunch-time on 29 March Mr. Payne flew to Athens to meet Mr. Dimitrios Bouras of Cellaway. We can only surmise that he learnt little of relevance in relation to risks of fraudulent trading in that Cellaway had only commenced trading in February. Furthermore a later Visit Report obtained by HMRC from a firm dealing with professional visit enquiries for another exporter established that Cellaway only ever imported into and then exported from Greece. Accordingly it had virtually no involvement with the Greek tax authority since that pattern of trading meant that it never had occasion to account for, or to seek to reclaim, VAT. Those facts also meant that it itself was never required to undertake any due diligence, and thus never did so. Mr. Payne said that he did not learn of that fact during his visit.

63. Of somewhat more relevance was the fact that Mr. Bouras was alleged by Mr. Payne to have taken Mr. Payne to a serviced office in order to conduct the meeting. This was somewhat odd since Cellaway's otherwise fairly uninformative fax on 28 March, and its 10 Purchase Orders all indicated that it traded from Mr. Bouras' family's private residence. Moreover the people undertaking the later visit referred to in the previous paragraph said that they were taken to that private residence. We were not even clear that Mr. Payne had noted the oddity of being taken to an office when none had been mentioned in any of the paperwork, and all the paperwork and faxes emanated from the private address, and we never learnt how the mismatch of addresses was accounted for.

The terms of the Appellants' purchases and sales in the April transactions

64. The written terms on purchase orders and invoices for the April transactions were always identical for each of the 10 transactions. The more striking fact was that there was an astonishing lack of attention to critical terms in the documentation, and when at just two points terms were indicated, Mr. Payne's evidence was either that the terms were mistaken and that the parties had orally agreed something different, or that in practice the relevant party had deviated from the asserted position.

65. The Appellants' purchase orders sent to Worldtech made no reference to when payment should be made, or indeed to any other term of contractual significance.

66. Worldtech's various invoices to the Appellants indicated the number of phones involved in each deal and the model of phone, i.e. either Nokia 8801 or Nokia 8800. There was nothing about title retention until payment, albeit that the invoice contained the words "Cash Basis". According to Mr. Payne, "Cash Basis" meant immediate payment, but this was then claimed in oral evidence to be a mistaken term in these deals since the verbally agreed basis of the deals was said to be that Worldtech gave credit for the full purchase price. No period of credit was specified (perhaps not surprisingly if the invoices contained words that were said to mean "Immediate payment"), and there was certainly no specific term that indicated that the element of invoice price owed to Worldtech equal to the Appellant's VAT-exclusive prices charged to Cellaway should be paid once Cellaway had paid one or other Appellant. Nor indeed the slightest indication of when the balance of the invoice price, roughly equal to the "VAT gap" should be paid, and whether any interest would accrue for late payment.

67. Cellaway's purchase orders from the Appellants were always in identical terms, in that they referred to the number of units and the model of phones, and then carried the words "Euro Spec subject to inspection, latest software, never locked, original box". This wording applied to the purchase of the Nokia 8801s which (as we summarise below) were hardly "Eurospec", so that Mr. Payne suggested at different points that there may have been a misprint in that the invoices probably meant to refer to Nokia 8800s, albeit that it was later suggested that the model number was correct and that the misprint was in requesting Eurospec phones.

68. Beyond the points just mentioned, the Cellaway purchase orders all also contained the terms "Payment on inspection" and the initials "n/a" in the column headed FOB. Both these terms led to further debate as to what precisely was contemplated, though it seems fairly obvious that the phones were to be shipped by the Appellants on a CIF, not FOB, basis, and that payment was to be made, following inspection. We will summarise further points in relation to payments and inspection after summarising the FCIB evidence below.

69. Turning finally to the Appellants' invoices, they simply referred to the number and model of phones, did not repeat the Cellaway wording about "Spec", and were otherwise entirely silent in relation to terms.

The financing of the April sales

70. As we have indicated, the March Worldtech deals were financed for the Appellants by a loan made to Sprint (followed by an on-loan to GSM), the amount of which was virtually identical to the Appellants' expected VAT-gaps on the deals in question. And as we have also indicated, the short loan agreement between Worldtech and Sprint provided for a "fee of 35% interest" for the loan's expected duration of 28 days. Also in March, Worldtech had extended further credit in the sense that it had not demanded payment of any element of the invoice prices charged to the Appellants until Cellaway had first paid the Appellants the slightly lower VAT exclusive prices charged by the Appellants.

71. The technical form of the April deals was very different, in the sense that there was no equivalent of the March loan, albeit that in reality the end result of full financial support from Worldtech appeared to be identical. For just as in March, as the evidence from the FCIB Paris server will show (see below), the Appellants derived credit firstly in the sense that they only on-paid the VAT-exclusive amounts paid by Cellaway to Worldtech when those amounts had first been received from Cellaway. More significantly, Worldtech appeared to make no sort of demand for the balance of the payments owed by the two Appellants. That balance, the equivalent of the VAT-gap that was financed in March with the £1.5 million loan, was the somewhat greater sum of approximately £2.04 million in April. Whilst there was not the overt financial support in April, equivalent to the March loan, when Worldtech was seemingly entirely content to leave the £2.04 million of the invoice prices outstanding until one imagines HMRC repaid the VAT reclaimed by the two Appellants, the position was in some senses odder still. For Worldtech was thereby providing exactly the same credit in substance as was afforded in March with the 28-day loan, save for the fact that in April there was no documented charge for credit of any sort. Since the Worldtech invoices provided for "Cash basis", said to mean

"Immediate Payment", they could hardly insert a credit charge to match the reality claimed by Mr. Payne, namely that credit was intended. Mr. Payne claimed in oral evidence that he believed or understood that the standard charge for credit of either 2% or 2 ½ % a month was intended or orally agreed. Not only was there of course no written confirmation that this was the intention, but if it was, one might be left wondering why the charge for credit might have dropped from 35%, coupled with utterly penal daily rates of penalty interest for late repayment, to a monthly charge of, relatively speaking, a modest amount.

72. When we described the circumstances relating to the March transactions and the March loan, we indicated that whenever Cellaway made payments to either of the Appellants, that Appellant would top up the payment then made to Worldtech, applying elements of the £1.5 million (directly or indirectly borrowed from Worldtech), so that once Cellaway had finished making its payments, the Appellants had in turn paid all the invoice amounts owed by them. What, at that point, the Appellants had failed to pay was that they had not yet repaid the £1.5 million loan, and they had not paid any of the £525,000 interest, or obviously any of the penalty interest.

73. What appears then to have happened, shortly after the Appellants had paid on the amounts received from Cellaway in the April deals, was that on 3 May, HMRC refunded to Sprint £2.59 million in respect of Sprint's March VAT repayment claim, and the considerably lesser amount claimed b y GSM. It seems that virtually immediately (not surprisingly since the 2% daily penalty interest rate was already accumulating on the March loan), Sprint paid Worldtech £1.5 million. We take this to mean that on 3 May, the principal of the March loan had been repaid, but as yet none of the interest had been paid.

74. The position thereafter is slightly involved. The points that are presently significant are clear enough though the detail of the payments made is something that Mr. Farmer had tried to understand, and our summary is based on his rationalisation. Unfortunately Mr. Payne for one certainly appeared not to recollect or understand the detail.

75. It seemed that at the end of the 12 rotations of invoice payments from Cellaway to the Appellants and to Worldtech (described below in relation to the FCIB evidence in order to focus on different points), the end position was that Sprint and GSM themselves had received everything due from Cellaway. In their turn, however, Sprint still owed Worldtech £1,543,300 and GSM owed Worldtech £447,700. That remaining indebtedness was approximately equal to the VAT-gap referred to in paragraph 71 above. At this point, various of the buffers and the defaulter were still owed invoice payments in roughly the amount of £2 million each, and the only company that had not only received everything due to it but very nearly £3 million too much was the company referred to as United Traders, the assumed non-UK supplier to the defaulter in these chains. The reason why United Traders had received "too much" was that the payer to it, the defaulter, West 1, wrongly paid an excessive amount (effectively on a VAT-inclusive rather than VAT–exclusive basis) to United Traders. This was presumably its method of ensuring that when failing to account for the VAT it, West 1, would have no cash available to meet any demand for VAT.

76. It seems that the receipt by Sprint and GSM of their March VAT repayments from HMRC on 3 May enabled those two companies to pay certain further amounts to Worldtech, in reduction of the amounts that remained outstanding, as mentioned in the previous paragraph. It appears that GSM fully discharged its debt in respect of invoices on 4 May, and that by 16 May, Sprint had reduced (but not eliminated) the remainder of its invoice obligations by paying a further £642,350. On 12 July Sprint paid a further £150,000.

77. The end position, after 12 July, therefore appears to have been that Sprint still owed Worldtech £749,950 in respect of unpaid invoice amounts, and £525,000 in respect of unpaid interest on the March loan (ignoring the penalty interest). Worldtech appeared, however, to have paid the buffer companies, and they in turn the defaulter, everything owed to them. The further payments to the buffers and the defaulter occasioned yet further payments to be made to United Traders, which appeared to end up with over £5 million more than it was owed.

78. There was no indication that Worldtech was pressing in any way for the remaining amount owed by Sprint to be discharged. On the contrary, when it emerged that HMRC were going to subject the Appellants' April claims to extended verification (which was notified to Sprint by HMRC in a letter of 30 June 2006), and when HMRC eventually denied the repayments in August 2006, it was suggested by Mr. Payne that Worldtech then confirmed that the March loan could in retrospect be treated as having been an interest-free loan. This still of left Sprint owing approximately £750,000 to Worldtech, even if it was true that the interest on the loan was waived. It appeared that that amount of £750,000 still remained owing to Worldtech at the date of the hearing. Mr. Payne's observation was that it was not his fault that "his money had not been paid to him by HMRC", and seemingly Worldtech accepted this proposition. Moreover on two later occasions, Worldtech made further loans to Sprint, notwithstanding the continuing outstanding indebtedness.

The FCIB evidence

79. We considered the FCIB evidence in relation to the April Worldtech deals to be particularly significant.

80. According to the evidence produced by Mr. Farmer, it appeared that the payments in respect of all 10 Worldtech deals had been entirely circular. Ignoring the exact amounts paid at each point, the payments flowed first from a non-UK company referred to as Hunzie to Cellaway, then (in accordance with invoices at the following stages) from Cellaway to Sprint, to Worldtech, to the two UK buffers, and to the defaulter, which then paid the non-UK company, United Traders (this payment notably being for a full VAT-inclusive amount, rather than the lower invoice amount actually owed on the invoice by the defaulter to United Traders), and then (there being no invoice to match this payment) back to Hunzie. The timings on the Paris server indicated, in the usual manner for the payments in circular payment flows in MTIC chains, that the money generally returned to the entity that had made the initial payment within roughly one hour.

81. The next highly significant fact in relation to the payments in respect of the Worldtech deals is that it emerged in relation to the deal referred to as Sprint 1 that

the full amount owing by Celltech to Sprint had not been paid in one payment, but in three separate payments all on the same day. We accept that, at some steps in the deal chain for that deal, the deal had in fact been split into three separate invoices, but nevertheless the significant fact is that the timings on the Paris server indicated that the first part payment in respect of "Sprint 1" commenced with a payment by Hunzie to Cellaway at 18.30 on 25 April, culminating in Hunzie receiving a slightly lesser sum back again (from United Traders) (Hunzie and United Traders incidentally operating from the same IP address, albeit that the Respondents made nothing of this point) at 19.24 on the same day. The next payment flow appeared then to commence with Hunzie paying Cellaway the next instalment at 19.27, i.e. three minutes later, the money flowing round the circle in slightly varying amounts and returning to Hunzie at 20.03, whereupon at 20.06, after a further three minute gap, the money commenced a further rotation returning back to Hunzie (in admittedly now an enhanced amount) 42 minutes later.

82. These facts led the Respondents to contend that no party in the chains actually had the required £7 million plus, needed to satisfy the full invoice price or prices owed in respect of the deal "Sprint 1", so that lesser sums of money had to rotate in sequence in order to discharge or largely discharge (at the level of the payments by the Appellants to Worldtech) the full invoice amounts. The Respondents' claim went further than that however, in that it was contended that when all 10 deals were considered, the money rotated not three times but 12 times, leading to the claim that roughly the same money (augmented or diminished in fairly marginal amounts around the chain) flowed in order to discharge all the amounts owed in respect of all the deals effected in April 2006 between Worldtech and the Appellants. That aggregate amount was of roughly £30 million. The Appellants contended that the same sum of money could not have flowed in this way, without evidence that the phones had come back to the UK in the reverse direction, and we will defer giving our findings of fact in relation to the FCIB evidence until later. What is absolutely clear is that money flows did all rotate in a circular fashion, the rotation through 8 companies normally taking about 1 hour, and if the timings on the Paris server happened to be Continental European time (1 hour ahead of GMT) the rotations commenced in the evenings of 25 and 28 April.

The sequence of Freight Forwarder inspections, Releases and Payments

83. Whilst the Appellants' invoices to Cellaway had always been silent as to when title might pass and payment be owed, Cellaway's purchase orders had contained the terms that we mentioned in paragraph 68 above about freight and "payment on inspection". We took the natural meaning of these terms to mean that the purchaser or its freight forwarder would inspect the goods at their destination warehouse which was always in Germany and that payment would then follow a satisfactory inspection.

84. It is known that the goods were travelling by road and that late in the day on 25 and 28 April the lorries passed through the Channel Tunnel. Accordingly it was obvious that the goods could not have arrived in Germany until the 26 and 29 April. Furthermore if genuine inspections of 62,000 phones were to be undertaken in Germany by the purchaser, any sort of inspection would take some time.

85. Dealing first with any inspection by the Appellants, on the written terms of the instruction to the Appellants' freight forwarder sent by Louise Payne, the Appellants appeared only to ask for their inspection at a time that would have rendered any sort of inspection inconceivable, were the goods to be inspected after the instruction was faxed, but still in time for the goods to pass through the Channel Tunnel. Mr. Payne said that the position was that the written instruction was just a written confirmation of an inspection request that he would have given earlier on the phone.

86. One CMR accompanying one load of phones indicated that the destination warehouse ought not to release the goods to the consignee until so instructed by the relevant Appellant, but in this particular deal, there was a Release Instruction given to the UK freight forwarder which appeared to nullify the Ship to Hold instruction just referred to. Other CMRs appeared not to include any sort of "Ship to Hold" instruction.

87. More materially it was quite clear that all the payment flows from Cellaway in fact commenced either when the goods were still in the UK, or at least certainly before they could possibly have arrived in Germany. It actually seemed, though this cannot be said with certainty, that the phones would probably have been loaded on lorries to be taken through the Channel Tunnel before Cellaway had made its payments, though the certain fact is that the payments had clearly been made before the phones could have arrived in Germany. This led to a claim by Mr. Payne that Cellaway might have instructed the Appellants' freight forwarder to inspect the goods in the UK, and having received confirmation that the goods were "to specification", Cellaway might then have commenced payment. There was in fact no remote evidence that Cellaway did call for such inspections from the UK freight forwarder, and since the goods were being carried on a CIF basis, with Cellaway having indicated that it would only pay on inspection, it seemed highly improbable that Cellaway would have relied on an inspection at the point or origin, rather than destination. It was not even clear that Cellaway would have known where the goods were in the UK, and by which freight forwarder they were held Cellaway may not have been aware that the Appellants had seriously inadequate insurance cover for the transit (see below), though had that been appreciated, it would have been even less likely that Cellaway, acting independently, would have paid before the goods arrived in Germany.

88. We might add the marginal fact, namely that all the evidence suggested that any inspections undertaken by the UK freight forwarders had hardly been worth "the paper they were printed on", to quote the Respondents. Whilst the Appellants never advanced this contention, it seemed to us to be theoretically possible that as the goods had been in the same warehouse when held by the importer and the various buffers, it was conceivable that one rather more sensible inspection might have been undertaken at an earlier point. The freight forwarders might then have produced Inspection Reports in relation to the same goods to each party that wanted them and was prepared to pay for them. This was neither suggested, nor established. What did emerge was that the Polish sub-contract employees who were actually responsible for the inspections appeared to treat the inspections as a bit of a joke, albeit that the Appellants would not necessarily have known of this.

89. Whilst Mr. Payne may have been ignorant of the poor way in which it appeared that inspections were undertaken, we accept the claims made by the Respondents, namely that all the evidence given by Mr. Payne as to what he expected freight forwarders to do in effecting inspections was confused and unconvincing. We shared the impression gained by the Respondents that the inspections were seen as a formality and as window-dressing to present to HMRC, and not as any sort of genuine exercise in relation to the supply of £30 million worth of phones.

Insurance for the transit of the phones

90. Notwithstanding that the apparent value of the phones traded on 25 and 28 April was in the region of £30 million, Mr. Payne conceded that the limit of the Appellants' insurance cover, covering transit, was £1 million. He said that the security on the lorries that carried the phones was "second to none", but then conceded that the transit was conducted, not by his freight forwarder, or the freight forwarder whose warehouse the first freight forwarder was using on some terms, but by some sub-contracted transport company, whose identity was unknown to him.

The types of phones traded in April and whether such sales might be realistic sales in the legitimate grey market

91. We will defer our findings of fact in relation to two matters concerning the particular model of phones being sold in April, but we should immediately say that there was considerable debate in relation to the sale of all the phones in April for two different reasons.

92. We were told, and this seemed to be accepted, that the Nokia 8800 and 8801 phones were "high-end" and thus expensive phones. They were essentially similar, save that whilst there was some contention about the following facts, it seemed that the 8800 was the phone with the charger plugs, frequencies, antennae and guarantee terms targeted at the European market, whilst the 8801 phones were identical save for the fact that material differences in the four attributes just summarised indicated that these were the phones aimed at the USA and Central and Southern American, not the European, markets.

93. The strong claim made by the Respondents was that the 8801 phones were not suitable for sale in the European market, so that it was decidedly odd that the Appellant was selling 28,000 of these phones, that had implicitly been imported into the UK with European plugs on them, back to Europe. Whilst it was possible that the Greek purchaser that requested that the phones be delivered in Germany, might have planned to on-sell them to Latin America, it still seemed decidedly unlikely that in legitimate trading these phones would have first been sold into the UK, and then exported to Greece or Germany if in fact (this being pure speculation) the Greek purchaser might on-sell them to Latin America. Since Cellaway's purchase orders requested "Eurospec phones", this also appeared to render on-sale to the USA or Latin America to be somewhat unlikely, albeit that the phones supplied were in fact not "Eurospec phones".

94. The unrealistic nature of any expectation that the phones might eventually be retailed in Europe was suggested by the Respondents to be non-existent, the

Respondents relying on the statistic that in the GfK German marketing firm's data for retail sales at "point of sale" in the 22 major European countries and the UAE, no 8801 phones were retailed in April 2006 at all and only 299 such phones were sold on a retail basis in the whole of 2006. To cap the oddity, the Appellants were selling the 8801 phones at a slightly higher price than they were selling the 8800 phones, which were clearly designed for the European market.

95. One other piece of material evidence was given in relation to the 8801 phones by Mr. Payne. It was common ground that the phones would operate, at least on some mobile systems, and in parts of Europe, though in contrast to the 8800 phones designed for the frequencies in Europe, the 8801 phones would not work everywhere not on every mobile system. In support of the proposition that he had found the phone to be perfectly satisfactory, Mr. Payne said that for a period he had actually himself used an 8801 phone. This he had acquired when the supplier that had sold Sprint the pre-production phones in March referred to in paragraph 43 above had sold a batch of Nokia 8801 phones to Carphone Warehouse. When Carphone Warehouse appreciated that the phones carried no Nokia guarantee for sale in Europe, Carphone Warehouse had returned the 8801 phones to the supplier, and it was then one of these phones that Mr. Payne had acquired. Whilst we accept Mr. Payne's evidence that the phone had worked (it being clear that it would indeed work in some European countries and on some networks), we note what we consider to be the far more important fact, namely that a UK retailer had rejected the 8801 phones.

96. The different point of contention in relation to the April sale of 34,000 Nokia 8800 phones was that, whilst this was the model targeted at the European market, it was suggested by the Respondents that the volume sold was vastly excessive for any level of trading in the legitimate grey market having regard again to the volume of retail sales of these phones indicated by the GfK survey. We were told that the Nokia 8800 ceased production in May 2006, albeit apparently to be replaced by a phone called the Scirocco or perhaps Scirocco 8800, which was virtually identical apart from the fact that it was finished in chrome. There was certainly no clear argument advanced as to why a vast volume of these phones might be traded on the legitimate grey market. There were no material Sterling/Euro exchange differences during the spring of 2006, no realistic prospect of a substantial volume of phones coming to the grey market on account of box-breaking, and whilst admittedly the 8800 itself was coming to the end of its marketing cycle, it was neither obvious that prior holders would be "dumping" such phones, or indeed in the reverse direction that purchasers might be seeking supplies before they ran out for a model that had been popular. Again we will defer our findings of fact, but the Respondents' case was that the volume of these phones sold was so high as to be inconsistent with any conceivable legitimate grey market trading of such phones. In relation to the Respondents' contention that an implausible volume of Nokia 8800 phones was sold by the Appellants in April, it is worth noting that 30,500 Nokia 8800 phones constituted the entirety of the phones sold from Worldtech to the Appellants and on to Cellaway on 28 and 29 March, and in May yet a further 996 such phones were traded by Sprint.

The May and July deals

97. We deal now with each of the four categories of deal undertaken in May and July, that we mentioned in the last four bullet points of paragraph 26 above. We were given no information as to whether any transactions were effected in June, but just given the details of the seven transactions in May and July.

The further facts in relation to the first category of phone sold in the May and July periods

98. This deal was effected on 18 May, Sprint acquiring 996 Nokia 8800 phones from the company that we mentioned in paragraph 6 above, namely Devi Communications, and selling those phones to a Danish company called Trading Point Aps. With the marked exception of the margin made by Sprint's immediate supplier, i.e. Devi Communications itself (which we will address below), the earlier buffers made the traditional unit mark-ups of 50p, £1 and £1.

99. There are three particular facts to address in relation to the May 18 deal, beyond noting in passing that it involved yet a further transaction in Nokia 8800 phones, where on the expert evidence of Mr. Fletcher the deals 20 days earlier had more than saturated the retail market in this particular phone.

100. The first fact is that whether or not Sprint was required to effect due diligence on its trading partners, it did have:

- an "introductory pack" from Devi Communications, the supplier, signed by a Mr "Dipak Chhiber", Devi Communications' office address being in Wolverhampton, and
- some rather uninformative "due diligence" material from the customer, Trading Point Aps, much of it in Danish, indicating that the company had only been first registered in March 2006, and indicating that the Director was someone with the name "Parshotam Lal Chhiber", whose address was not in Denmark but in Telford.

Those facts would have alerted anyone to the possibility that the two companies were related. Although Mr. Payne said that he generally made Companies House searches in relation to the Appellants' trading counter-parties, he may have failed to do so on this occasion, but even without ascertaining from such a search that the two men were in fact brothers, both living at the same house, anyone should have noted that the name Chhiber was not particularly common and that Telford is a great deal nearer to Wolverhampton (in fact it is 17 miles away) than it is, for instance, to Copenhagen. The reality was that the companies were related and that Devi Communications had supplied directly to Trading Point Aps. Mr. Payne would not have known of those two facts for certain, but he had enough clear information to make the feature that something very odd was going on perfectly obvious.

101. The next material fact is that none of:

- Sprint's purchase order from Devi Communications;
- Devi Communications' invoice to Sprint;
- Trading Point Aps' purchase order against Sprint; or

- Sprint's invoice to Trading Point Aps

contained any terms as regards payment or title. We consider that a total absence of the minimum of required terms is strongly indicative that other matters were in fact implicit and understood between the parties. We consider this to be particularly significant when the timing and routing of payments demonstrated circularity; the payments also showed that the majority were only made by Sprint after Sprint had received part payment from Trading Point Aps, and when finally no party appeared to be troubled when the final payment was not made until approximately seven weeks after the phones were shipped to Denmark. During this period the phones were allegedly held in the destination warehouse on a Ship to Hold basis, since the release from that constraint was not given until the final payment was made.

102. We reach these conclusions because Mr. Farmer's FCIB evidence exhibits some circularity in the payments, and that, while the payment representing the VAT-gap (obviously inherently incapable of being paid out of a preceding receipt from Trading Point Aps) was paid out of Sprint's "other funds", the remaining payments to Devi Communications were preceded by a payment from Trading Point Aps.

103. The other fact that would have been noted by Mr. Payne in relation to the Devi Communications deal was that Sprint's profit margin on the phones in this deal was of only 5%, in contrast to the margins of roughly 10% made in the April deals. Mr. Payne may not have been aware that the explanation for this was that Devi Communications, Sprint's supplier, made a unit profit of £35.12 on supplying the phones to Sprint, whilst Sprint's profit (assuming the recovery of VAT) was to be only £19.50. In other words, Devi Communication's profit was not the buffer's conventional 50p or £1 per unit but a much larger share of the profit resulting from the VAT fraud. This was perhaps hardly surprising when Devi Communications and Trading Point Aps were companies run by brothers who lived in the same house.

The further facts in relation to the second category of May/July deals made on 24 May

104. These deals involved GSM and Sprint acquiring 1000 and 2000 Motorola V3 phones respectively from Lexus Telecom (the supplier for all remaining deals) and supplying those phones to a Hong Kong company referred to as Cetro Tek Holdings. As usual the four buffers in both transactions made the fixed margins of 10p, 15p, 20p and 50p, and Lexus Telecom's unit margin was £1.50.

105. There were certainly some unusual features to these deals. The deals appeared to have been introduced to the Appellants by a Cyprus company referred to as Segers Trading, operated by an individual resident in Ruislip namely Mr. Paul Richards. Segers Trading had had earlier contacts both with the Appellants and with Cetro Tek Holdings. The company was apparently well known to Mr. Payne, and Segers Trading and Cetro Tek Holdings had some sort of relationship in which each received commissions for introducing deals to the other. We might note, and will explain this below, that it appeared that in this particular deal Segers Trading was not acting just as a commission agent.

106. We were shown a fax from Segers Trading, dated 18 May, giving the details of Cetro Tek Holdings to Louise Payne, and Mr. Payne, indicating "They inform me they are looking for goods", and "Their freight agent in USA where a lot of these goods go are:" followed by the details of the Miami import broker.

107. Notwithstanding the introduction by Segers Trading, that Cyprus company was obviously not included amongst the buffer companies, though it is possible that it was the foreign supplier to Crossview (the defaulter), or located at some earlier point in the hidden part of the chain. We deal with a possible justification for this observation below.

108. Lexus Telecom's invoice, dated 24 May, included the text "All goods remain the property of Lexus Telecom (UK) Ltd until paid for in full". On the following day, Sprint's instruction to NatWest indicates that Sprint paid the full amount of Lexus Telecom's invoice price to Lexus Telecom's FCIB account, via Rabobank Nederland. Although the invoices suggested that all the various earlier buffers would receive and pay their prices and make the margins indicated in paragraph 104 above, Mr. Farmer's FCIB evidence indicates in a manner that we considered to be sufficiently reliable that the actual payments omitted the payment of the full invoice amounts to the first buffer and the defaulter. A very small amount was paid to the first buffer, but the second buffer appeared to pay the balance of its receipt to a non-resident company referred to as Bruins Consortium, on the authorisation of that first buffer, and Bruins Consortium then paid on all but £450 to Segers Trading. This is why we suggested in the previous paragraph that Segers Trading may have been the original supplier of the phones. We might add the point that whilst Sprint and GSM paid separately for their respective orders of 2000 and 1000 phones, at other steps in the payment chain, the payments covered all 3000 phones.

109. The Motorola phones in question appeared to have been despatched to an address in Miami, and perhaps also to an affiliate of Cetro Tek Holdings rather than to that company itself, namely Cetro Tek International. One document suggested, though it was claimed that this was a mistake, that the goods were in fact consigned to Segers Trading. We were also told that the man behind Cetro Tek Holdings was a Mr. Housefield, the ex-CEO of a major US authorised distributor called Brightpoint, and the suggestion was that Cetro Tek was buying the Motorola phones for onward sale to Brightpoint.

110. Although the invoice prices at which the two Appellants sold to Cetro Tek Holdings would have generated a profit, assuming the repayment of the VAT, these deals actually occasioned near total losses, since it appears that Cetro Tek Holdings initially failed to pay the price altogether, notwithstanding that the goods had (allegedly mistakenly) been released to it. We were shown various e-mails passing between Mr. Payne and Mr. Housefield in relation to the non-payment. It appears that the non-payment may have resulted from some difficulty with Chinese exchange control, though if the phones were being despatched to an affiliate of Cetro Tek Holdings in Miami for on sale to a major US distributor, it was never clarified why Chinese exchange controls or money laundering regulations were relevant. The e-mails from Mr. Housefield suggested that if the Appellants issued new invoices purporting to evidence supplies of other goods for the same price, or possibly for a lower price augmented by a separate fee (the aggregate of price and fee then either

equalling the original price, or possibly that price plus 2% interest for late payment), then Cetro Tek Holdings would be able to pay the re-invoiced price. It seems hat Mr. Payne was ultimately unwilling to proceed in this manner, and although we believe that some element of the price was eventually paid, it appears that the full price was certainly not paid.

The further facts in relation to the third further category of deal involving Lexus Telecom, each Appellant and Naam Electronics

111. These deals involved the purchase and sale from Lexus Telecom of 500 and 1,500 Nokia N70 phones on dates between 13 and 20 July, the 500 being purchased by GSM and the 1500 by Sprint. The Appellants' customer, Naam Electronics was based in Dubai and the phones were despatched to the Dubai Airport Free Zone.

112. There was very little evidence in relation to these transactions, particularly evidence that might have a bearing on the "knowledge and means of knowledge" issue. This is largely because although it was initially suggested, and certainly stated by Louise Payne that Mr. Payne had negotiated all the deals, it emerged (only on the last day of the hearing) that Mr. Payne claimed that he had been on holiday when all the July deals had been done, namely these two deals with Naam Electronics and the final two deals with Sotodelia which we will deal with below. Although Mr. Payne had had a long time in which to prepare for the hearing, he suggested on the last day of the hearing that he was not the right person to speak to about the Naam Electronics deals. He thought that someone called Belinda may have had some involvement with the July deals, though he did say that he was aware of the deals *"over the telephone"*. He also said that *"I actually can't remember who, um – who found the customer, Naam Electronics, in the office. As I say, I was on holiday at the time."* He did however confirm that in relation to the Naam Electronics and Sotodelia deals, *"he oversaw them"*, and was in periodic phone contact.

113. Not that it is of much relevance to the "knowledge and means of knowledge" issue, we do know in relation to the Naam deal that the buffers and Lexus Telecom (the supplier to both Appellants) made the fairly traditional "buffer margins", albeit that the second buffer made a slightly curious unit profit of £1.91 per phone. Apart from a title retention term inserted into Lexus Telecom's invoices, the other transaction documents, including in particular each Appellant's invoices to Naam Electronics were entirely silent in relation to terms.

114. Of more significance in relation to the "knowledge or means of knowledge" issue were the facts that:

- Segers Trading appear to have been involved in some way with this deal, as with the Cetro Tek deals, in that they are mentioned as the consignee on one of the documents. Perhaps more relevantly, although both Naam Electronics and Lexus Telecom did not have FICB accounts, so that tracing monies is not quite as simple as in the April deals, it does appear that once Lexus Telecom had paid its supplier for the 2000 phones, the money did appear to have flowed swiftly through seven companies before then seemingly being paid to Segers Trading.

- The order of events in this deal was somewhat extraordinary. Lexus Telecom invoiced the Appellants on 13 July, when the goods were in the UK and, as mentioned, with the term that they retained title until payment. Notwithstanding that term, it appears that the Appellants transported the goods to Dubai on either 16 or 17 July, notwithstanding that it was only on 19 and 20 July respectively that Naam Electronics faxed their introductory letter to the Appellants and that the Appellants invoiced Naam Electronics. Payment was then made to and by the Appellants on 24 July, though timings are not available since neither Naam Electronics nor Lexus Telecom had FCIB accounts.
- The third point of some significance is that Mr. Payne was unable to explain anything further in relation to these deals. Indeed virtually all the information in relation to these deals emanated from HMRC and the documents, rather than from Mr. Payne's evidence

The further facts in relation to the fourth further category of deal involving Lexus Telecom, Sprint and Sotodelia

115. The final deals with which we are concerned are two small deals, both effected between Lexus Telecom, Sprint and a Spanish customer referred to as Sotodelia, both occurring on 28 July and involving 1,400 Nokia N70 phones and 1,200 Nokia N71 phones. Amongst irrelevant facts for present purposes are the facts that the two buffers before Lexus Telecom made unit mark-ups of 15p and 50p, and Lexus Telecom made £1 per phone.

116. The facts that are of more significance were that:

- Mr. Payne had no idea how Sprint came to know of this customer, and he did not know whether Sotodelia had located Sprint or whether Sprint had located Sotodelia;
- The documentation suggested that Sotodelia only introduced themselves to Sprint on 28 July, the day of the trade, sending a slim pack in Spanish that indicated that Sotodelia had only been first registered for VAT purposes on 21 April 2006 and that its trade was in IT products as distinct from mobile phones. The introductory pack indicated that the director was a Patrick Dymond, and whilst Mr. Payne would not have known this it also appears that the owner of the company was a Mr. Ashley Drake of South Leigh, Oxfordshire.
- Notwithstanding the Lexus Telecom title terms, and the fact that the payments did not circulate until 1 August, it appears that the phones were shipped to Spain on 26 July.
- Perhaps the most significant fact is that the FCIB evidence demonstrated that the precise margins made by all parties in the transaction chains in both deals, involving the N70 and the N71 phones, exactly matched to the last £, the amount of the VAT default.

The contentions of the Respondents

117. We will deal, in the opening paragraphs of our Decision, with one argument advanced on behalf of Respondents in relation to the *Kittel* test. Beyond this, there was little dispute or discussion about the law. Accordingly the Respondents' contentions were all directed to addressing the evidence. In particular it was claimed that:

- Mr. Payne had lied in giving some of his evidence;
- In other respects, Mr. Payne's evidence had been vague, his oral evidence sometimes at variance from the evidence given in the Witness Statements, and also inconsistent with other evidence given orally by him;
- It was clear and undisputed that the Appellants' transactions were connected with fraudulent VAT losses;
- Finally there was ample evidence that the Appellants knew, or at the least, ought to have known, that their transactions were so connected to VAT frauds.

The contentions of the Appellants

118. All the contentions related again, as with the Respondents, to observations and claims geared to the evidence, rather than any legal points of distinction, save for the contention already referred to in relation to the burden of proof. As regards the evidence it was contended that:

- since Mr. Payne had never before been accused of any form of dishonesty, and since both Appellants, particularly Sprint, had been involved in legitimate grey market trading in mobile phones, it was highly improbable that the Appellants would have knowingly undertaken transactions connected to MTIC fraud;
- the contention just summarised should require the Respondents to satisfy a particularly high level of proof before we concluded that knowing participation in fraud had occurred.
- the Appellants had traded in no different manner in the periods April, May and July 2006 than they had done in earlier periods when all claims had been accepted and paid by HMRC; and
- since HMRC had given the Appellants no notice that their trading counter-parties were regarded as suspect, and since it took HMRC many months to complete their extended verification and finally dismiss the Appellants' claims for refunds, how could the Appellants, with less opportunity to research transaction chains, expose the connection to fraud when the Appellants' own suppliers had accounted for VAT?

Our decision

The correct summary of the Kittel test

119. There was some discussion, particularly occasioned by counsel for the Respondents, as to the correct way to apply the *Kittel* test, and as to how to interpret and apply the decision of the Court of Appeal given by Lord Justice Moses in *Mobilx,* EWCA Civ 517, [2010] STC 1436.

120. Insofar as we understood the Respondents' contention it was designed to rebut a construction of Lord Justice Moses' language in *Mobilx* that seems to us neither to be a tenable construction, nor to have been the intended construction of the decision or its reasoning. We do not furthermore understand the Appellants to have advanced the strange construction that the Respondents were at pains to challenge.

121. The point in issue appears to have been whether Lord Justice Moses had sought to modify the *Kittel* test such that it would only be satisfied if the Appellant knew or ought to have known that there was no other reasonable explanation for the transactions than connection to fraud, so that critically if there were two reasonable explanations for the transactions (one being connection to fraud and another being a perfectly legitimate grey market transaction), then the appellant's appeal should succeed because the Crown would not have established that connection to fraud was the only reasonable explanation. There was another legitimate explanation which was also tenable.

122. It seems perfectly obvious to us that this is not what Lord Justice Moses meant, or indeed what he said. The reference to "reasonable explanation" emerged in the part of the decision where Lord Justice Moses was considering whether the Crown had to establish knowledge or means of knowledge to the effect that the transactions ***were connected to fraud***, or whether it was sufficient for the Crown to show that the transactions ***were more likely than not*** to have been connected to fraud. Whilst the clear answer to this was that the former had to be demonstrated, the subsequent reference to "the only reasonable explanation for the transactions being connection to fraud" appears to have been intended as a sensible paraphrase, and perhaps a slight softening of the level of knowledge required to establish ***actual connection to fraud.*** It seems to us to have been a point intended to assist the Crown, in very slightly qualifying the notion of ***knowledge or means of knowledge of an actual and definite connection.*** It was not intended to provide appellants with the available argument that if they could show that some other reasonable explanation for the transactions was tenable, their appeal should inevitably succeed. If an appellant could assert some other reasonable explanation, then the appellant might sustain his appeal by showing that the Crown could only establish, at best, the insufficient ***"more likely than not"*** conclusion. But if the Crown could establish knowledge or means of knowledge in any other way, then the appeal should still fail.

The standard of proof

123. There was considerable dispute between the parties in relation to the standard of proof that had to be established by the party (obviously the Respondents) with the burden of proof, before we should legitimately reach the conclusion that the Appellants either knew or ought to have known of the connection of their transactions to fraudulent VAT losses.

124. The Appellants initially referred to certain inconsistent judicial references that were quoted to us, one suggesting that there were, and another suggesting that there were not, circumstances in which the criminal standard of proof should apply in some civil cases. We need not seek to reconcile those conflicting statements or indeed to quote them ourselves because the ultimate proposition advanced on behalf of the Appellants was that the civil standard of the balance of probability was the correct

standard, albeit that the standard of proof should reflect the circumstances. Thus insofar as some particular conclusion was improbable it was suggested that the standard of proof should reflect that and a higher standard be required to conclude that something improbable had occurred, in contrast to the case where some outcome was relatively likely. It was then asserted that Mr. Payne was obviously a person of undoubted integrity, that he had never committed any sort of offence and that because it was thus extraordinarily unlikely that he would, as a legitimate grey market trader, have undertaken transactions known to result from VAT fraud, we should be very slow to reach the conclusion that the Appellants failed the knowledge and means of knowledge features of the *Kittel* test.

125. We accept that the question that we must address is a serious one and that any conclusion that the Appellants knew of the connection of their transactions to fraudulent losses should not be reached lightly.

126. We are however reluctant to accept the proposition, strenuously asserted by the Appellants' counsel, that we should approach this matter in any different way than in all other MTIC appeals. Whilst the admitted feature that these Appellants had plainly traded in the legitimate market in grey market phones might render their participation in fraudulent deals less likely than the circumstances of the trader that switches from some quite different trade to a vast turnover in mobile phones or CPUs, the converse is equally cogent. In other words, as the Respondents contended, MTIC fraud had regrettably been so extensive that the proposition that it was highly improbable that any legitimate grey market trader, in fact trading mobile phones in back-to-back deals in vast quantities, would be involved in fraudulent transactions was dubious. Moreover, no better cover could be found by the mastermind behind fraudulent transactions than to channel fraudulent deals through a legitimate grey market trader, were there one who could be duped, **or persuaded**, to participate in the chains as the exporter.

127. Far more relevantly, however, we note that whilst the Appellants' counsel was repeatedly criticising the Respondents' counsel for making assertions and not producing evidence, it was only the Appellants' counsel's assertions, rather than any evidence on which the claims about Mr. Payne's integrity were based. We regret to say that the conclusion that we reached, particularly in relation to all the deals involving Worldtech in March and April, but also on account of the whole tenor of Mr. Payne's evidence, is that we find those protestations by the Appellants' counsel to be wholly unconvincing.

128. We repeat therefore that we do accept that we must certainly justify and explain any conclusion that we reach to the effect that the Appellants knew of the connection to fraud. We do however consider that the standard of proof incumbent plainly on the Respondents is the civil standard of the balance of probability. We are equally prepared to apply that test by reference to all the circumstances, albeit that when that means in the present case that we may, and must, look to all the circumstances of the March and April transactions, the contention is certainly not one that provides the Appellants with a remotely tenable case.

Reliance by the Appellants on earlier repayments of input tax by HMRC

129. We will also comment generally on the contention that was also advanced with force on behalf of the Appellants, namely that they derived confidence that there was nothing suspect in their trading from the feature that HMRC had on various occasions met their claims for input tax repayments. Furthermore, HMRC had not indicated suspicions in relation to any of their trading partners.

130. The first observation is that it is always difficult to discern whether claims by appellants of this nature are genuine, or whether the reality is that brokers (i.e. exporters) were amazed at the regularity with which HMRC (particularly prior to, say, Spring 2006) failed to undertake full extended verification and thus repaid possibly dubious claims. It is certainly the case, particularly after the *Optigen* decision in very early 2006, that the masterminds behind the frauds deliberately inserted steps to render challenges by HMRC more difficult, and likely that many broker traders will have been "laughing all the way to the bank", rather than genuinely deriving confidence in their trading from the acceptance of demands for repayment of input tax.

131. It is also worth saying that HMRC's duty of confidentiality towards "other taxpayers" made it impossible for HMRC to indicate that trades should not be undertaken with a particular entity, unless that entity had actually failed to pay tax that was due. Redhill confirmations of the continuing validity of VAT registrations always made it clear that they were no sort of "kite-mark" for the trader whose registration was confirmed, and that it was always incumbent on the trader to check out its own trading counter-parties, and take its own decisions on its own best judgment.

132. Having summarised the reasons why reliance on past repayments by HMRC should not have led to confidence in an appellant's trading pattern and partners, we do accept that the question that we have to address is what the trader genuinely thought. And, improbable as it might be, or improbable as it should have been, for the trader genuinely to derive confidence from past repayments by HMRC, there must be cases where traders will genuinely have been influenced by such repayments.

133. This case does not, however, fall into that category. It is other factors that lead us to conclude without hesitation, certainly in relation to their April transactions, that both Appellants actually knew of the connection of their transactions to fraudulent losses. In view of this we reject all the arguments to the effect that these Appellants believed, partly in reliance on absence of challenges from HMRC, that their deals were not connected to fraud.

134. We referred in paragraph 11 above to one occasion where the Appellants challenged the evidence of Mr. Chambers. This related to the explanation given for the fact that, although HMRC asserted that they had intended to deny the repayments to both Sprint and GSM in respect of their April, May and July deals, and had indeed denied the repayments to Sprint, they initially refunded the input tax reclaimed by GSM in respect of its deals in April and May, albeit on a without-prejudice basis and subsequently made assessments to recover the tax that they contended had been wrongly refunded. The repayment to GSM was made in August 2006.

135. Mr. Chambers had explained that the repayments to GSM had always been made in error on account of some confusion between departments of HMRC, and that no distinction had been intended to be made between the claims made by both companies.

136. The Appellants' counsel sought to argue that the repayment to GSM indicated that HMRC had tightened up their verification procedures at around April 2006, and that the genuine intention had been to repay the amounts to GSM under the original procedures. Moreover the fact that the repayment was initially made was a factor (albeit an irrelevant one in relation to these Appeals since the repayment was made after the deals presently in contention) that gave the Appellants further confidence in the proposition that their deals were acceptable to HMRC.

137. As we indicated during the hearing, we accept that the repayment to GSM was made in error, and made because of some confusion between two departments of HMRC. It may be that HMRC were somewhat slow to admit to the error, but that was doubtless explained by embarrassment at having made a somewhat serious error.

138. As to whether we consider that the repayment to GSM was a factor that the Appellants could rely on in order to claim confidence in their procedures by HMRC's acceptance of their claim, we repeat that this point is irrelevant since the repayment was only made in August. Moreover, we refer to the conclusion that we gave in paragraph 133 above, in relation to the general proposition of the Appellants claiming that they derived genuine confidence in their deals on account of absence of challenge or warnings from HMRC. Were the complaint on the part of the Appellants' counsel that HMRC had tightened up their verification procedures in around April 2006, we altogether fail to understand the complaint since the factors that HMRC must still demonstrate, themselves satisfying the burden of proof, leave appellants with no legitimate complaint.

The need to identify the nature of the fraudulent evasion, or, for instance, the identity of the defaulter

139. The argument was also advanced on behalf of the Appellants that the Respondents ought to be demonstrating some knowledge on the part of the Appellants in relation to the circumstances of the original default or the identity of the defaulter. This is incorrect. The Respondents need simply to refer to the overall circumstances of the transactions and if these circumstances make it clear that the Appellants must have known that their transactions were connected to fraudulent evasion, then their Appeal fails.

Formal decision in relation to the connection between the Appellants' 17 deals and fraudulent VAT losses

140. Although this issue was not in contention, we ought to make, and thus now make, a formal finding to the effect that all 17 contested transactions were connected to VAT frauds. This was made clear by the Witness Statements, by the whole summary of the transactions and by the feature that it was in any event conceded by the Appellants. This finding means that the only issue for us to determine is the

"knowledge and means of knowledge" issue, to which all the attention was given during the hearing.

Our decision in relation to the April transactions

141. Virtually all of the Appellants' March 28 and 29 transactions, and every single one of the ten April transactions, involved purchases from Worldtech and sales to Cellaway.

142. We know from HMRC's evidence that in March,if not before, Worldtech itself exported product, all of which had been provisionally traced by HMRC to fraudulent tax losses, and we also know that Worldtech was well aware of the existence of Cellaway. After all it was Worldtech that had acted as referee to enable Cellaway to open its FCIB account in January 2006, one month before Cellaway undertook any sort of trading.

143. From the facts just given, and from the fact that the Appellants needed loans or credit from Worldtech to effect their March and April deals, it is first clear that Worldtech could have prevented the Appellants from effecting any of their March and April deals and Worldtech had the funds to export everything traded through the Appellants in March and April to Cellaway itself. It also seems highly likely that it was Worldtech that initiated by steps (possibly, we accept, steps by Cellaway) that gave the Appellants the initial contact for Cellaway for the initial March deals, and that it may very well not have been by pure chance that Cellaway happened to contact the Appellants in order to purchase the phones invariably provided by Worldtech.

144. We then note the extraordinary facts. We then observe that it was Worldtech that financed the Appellants to undertake their March and April trading, both giving credit for the element of their invoice prices matched by the VAT-exclusive prices receivable from Cellaway until the latter were received, and giving either a loan or undefined credit (in March and April respectively) for the VAT-gap. Without that loan and credit, it seems obvious that the Appellants could not have effected any of the transactions, and equally obvious that Worldtech could have effected all of them directly.

145. As it was, it was Worldtech that supplied all the stock, Worldtech that very likely provided the purchaser from the Appellants, Worldtech that provided the entire funds to finance the deals, and Worldtech that effectively took the risk of any non-refund of VAT. As indeed transpired, notwithstanding that the March claims were largely met, it inevitably followed that if the Appellants failed to recover the input tax reclaimed in respect of the April deals, it was going to be Worldtech that would ultimately be unable to recover much of the interest on its March loan and the very substantial balance of the April invoice prices owed to it.

146. Against the perfectly evident and fairly extraordinary reality just summarised, it is difficult to see why the deals were done on the basis that they were, namely that Worldtech put on a plate for the Appellants every ingredient of the deals, and enabled the Appellants to make (or hope to make) profits of over £1.5 million in March, or over £1 million taking the 35% interest charge into account, and £3 million in April when adding no value and effectively doing nothing. All that the Appellants had to

do was to prepare a bit of paperwork which was done extraordinarily badly (or possibly it had to be done without referring to the reality of the deal between the parties because that reality was too embarrassing to record in writing), and in return for that (taking the extreme facts for April) they expected to make a profit of roughly £3 million, entirely provided by Worldtech.

147. Mr. Payne endeavoured to explain away the allegedly high 35% interest charge on the March loan, and certainly suggested that it resulted simply from the production of a standard form agreement, and that the agreement between the parties was that the high interest rate would not be charged. Perversely the stated interest charge appears to us to be the only term that actually made sense, in that it would have been by virtue of that interest charge that Worldtech would have acquired its share of the March profits in return for having provided and financed those profits. On our calculation, Worldtech's share of the total profits would still have been substantially less than the Appellants' share of the March profits and Worldtech would have received a larger and more realistic share of the March profits had the Appellants' repayments been somewhat delayed (as they were) beyond the 28-day period such that Worldtech would have been entitled to a considerable further payment by virtue of the 2% daily compound penalty interest rate.

148. The position for April is however even more extraordinary in that, on the basis of the actual provision of credit, and the absence in any documentation of any charge (equivalent to the March interest rate) for the credit, Worldtech effectively gave the Appellants £3 million, stood to gain nothing (except possibly 2 or 2 ½ % interest a month if Mr. Payne's protestation was true) and took the entire risk.

149. Before listing other almost equally extraordinary features of the Appellants' April deals, we reach the conclusion that it is inconceivable that the Appellants can have believed that their March and April Worldtech/Cellaway transactions were transactions in ordinary *bona fide* trading. Even without asserting or suggesting what we consider may have been the realistic relationship between the parties, we say that the ludicrous nature of these dealings between Worldtech and the Appellants was such that the Appellants must have known that these transactions had nothing whatever to do with legitimate grey market trading.

150. We put to Mr. Payne our supposition which was that Worldtech was using the two Appellants as traders likely to be somewhat less visible on HMRC's radar screen as the parties that actually made the input tax recovery claims. By virtue of the facts that the two Appellants had plainly undertaken legitimate grey market trading and that there were two companies to share the quantum of the repayment claims (alongside claims simultaneously made by Worldtech), it seems to us to make perfectly good sense that there was some form of arrangement between Worldtech and the Appellants to achieve this result. We do not believe that the Appellants were oblivious to this reality, or the essence of the deal, whatever it was.

151. We accept that the documentation in relation to the April deals provided no overt channel by which Worldtech might derive some profit or advantage in return for providing to the Appellants every ingredient that enabled the Appellants to make over £3 million profit in two days for effectively doing nothing. This does not lead us to doubt our conclusion that the relationship between Worldtech and the Appellants was

wholly uncommercial, and indeed one where some other aspect of the deal, hidden to us, would explain why Worldtech was effectively totally generating the Appellants' transactions. After all we note that on the rare occasions when there were written terms in the documentation between Worldtech and the Appellants those terms did not reflect the reality. This we believe was because it would have been too embarrassing to have recorded the reality of the provision of credit. When Sprint failed to pay most or all of the interest on the March loan and something approaching £0.75 million in respect of the balance of the April invoice prices, the feature that Worldtech apparently waived the interest on the loan and appeared not to seek to recover the balance of the invoice prices, is most certainly not the conduct of an *arms' length* trader in genuine grey market trading. Accordingly some very curious understandings between Worldtech and the Appellants obviously existed and supplemented or reversed the skimpy documentation that in fact existed. In view of this we have no hesitation in concluding that, whilst we do not know what Worldtech hoped or expected to gain from the apparent manner in which it passed every ingredient of the April deals to the Appellants (save for its relatively modest £1 per unit margin), some undisclosed arrangement must in fact have existed. The actual terms were so unbelievable and so uncommercial that we cannot, and do not, accept that they revealed the genuine relationship between the parties.

152. The Appellants must have been aware of this obvious reality, and when in April 2006 MTIC fraud was so prevalent, the fact that the Appellants must have known that their deals were not *bona fide* commercial deals can lead to no other conclusion than that the Appellants had actual knowledge that their deals were connected to VAT frauds.

153. Whilst our decision in relation to the April deals is largely based on the uncommercial nature of the whole relationship between Worldtech and the Appellants, we now list other features of the April transactions that indicate that the deals must have been pre-planned, and that if the chain payments, for instance, were to circulate smoothly, each party had to know precisely the role that it had to play. These points put our clear conclusion well beyond doubt. These further features were as follows:

- It is unusual to find that one supplier manages to provide the stock, in the models, specification and quantities, that one and the same customer happens to want to buy in 10 transactions all undertaken on one day each, in just two days very close to the end of the Appellants' monthly VAT periods.
- Since all the stock was of relatively valuable phones, and temporarily ignoring the fact that we doubt whether there was any serious market in Europe for the 8801 phones at all, it is perhaps not surprising that the Appellants' profit margins in all ten deals were fairly constant. At the level of slightly more than 10%, however, those margins were improbably high, delivering a profit of £3 million for producing a few seriously inadequate bits of paper. We conclude that such profits in April were not only "too good to be true", but manifestly ludicrous. Whilst the Appellants never specifically claimed that they had been "duped" into performing the role that they performed, it is inconceivable that a fraudster, duping an ignorant and innocent party, would

actually act so as to give that ignorant party £4 million in a few days for doing virtually nothing.

- It is common in MTIC chains for the purchase order and invoice terms to be fairly brief, but they do sometimes make some sense. In the present case, the documents failed to provide the bare minimum of terms. Worldtech's invoices and Cellaway's purchase orders were the only documents that referred specifically to some contractual term, the former indicating "cash basis", and the latter indicating "TT payment following inspection". Neither of these terms was in fact honoured. We reject the suggestion that the reference to "Cash basis" was in fact a mistake on all 10 invoices. It was manifestly too embarrassing to provide for "Full credit, the majority until Cellaway (or whoever you sell to) has paid you, and the balance until, or rather, perhaps, the balance only in practice if and when, you recover the VAT from HMRC". It is perfectly obvious that "Cash basis" looked better on the invoices, and might escape further scrutiny, particularly if HMRC never obtained the FCIB servers. This would have been equally obvious to the Appellants as to Worldtech. As to the Cellaway purchase orders, there was no obvious reason why Cellaway would not have waited to receive the goods before commencing payment, so that its purchase terms would not themselves have drawn the Appellants' attention to the connection to fraud. All that we note is that Mr. Payne's suggested explanation for Cellaway having paid before the goods could have arrived on both relevant dates, 25 and 28 April, was obviously a feeble effort to explain away a fact that had in retrospect further clarified the fraudulent nature of the transactions.
- We do not regard the due diligence done by the Appellants in relation to Cellaway (which on any basis contacted the Appellants who knew nothing about Cellaway, with Cellaway moreover having only commenced business in February) as a serious effort to vet the customer, and we consider it extraordinary that Mr. Payne appeared to have failed to note that he was taken to an address in Athens that none of the documentation mentioned. Other evidence of course (albeit that the Appellants were not necessarily to know this) indicated that Cellaway on-sold the phones to a Spanish company for a margin of 50p a phone, and appeared thus to do nothing genuine with the phones. Cellaway certainly did not on-sell the 8801 phones to the USA, Central or Southern America, the areas at which they were apparently targeted.
- The payments appeared to have been entirely organised to rotate, and roughly the same sum of money appeared to commence the next cycle precisely three minutes after being recovered by Hunzie at the end of its previous payment cycle, with everything working like clockwork. We cannot believe that some mastermind could have made the arrangements for the numerous and rapid circulation of money (all through FCIB accounts) without every party being instructed exactly how and when to perform its designated role in making the next payment. It is inconceivable that the mastermind could have relied on the Appellants buying and selling to the chosen parties, making each of the 12 payments exactly as and when required, and refraining from making searching enquiries about the genuine nature of the transactions, without confidence that the Appellants were fully conversant with the fraudulent reality of the transactions.

- We are unpersuaded by the arguments advanced by the Appellants' counsel to the effect that the 12 rotations of payments cannot have been of the same money. Arguments, referring to certain LIFO and FIFO claims, we considered to have been ridiculous. Insofar as the contention was that when the first payments had been made by the defaulter to its non-UK supplier, the money in question would inevitably have then passed to the authorised distributor or other genuine entity that had initially provided the phones, this appeared to be pure speculation. We had no idea where the phones had initially been acquired, and it seemed perfectly likely that the phones and the money had been circulating in other transactions, prior to the Appellants' April transactions. It is not beyond the bounds of possibility that some of the 8800 phones were amongst those dealt in on 28 and 29 March. In any event the apparent reality that roughly the same sum of money rotated, as Mr. Farmer's evidence suggested, through 12 rotations, each commencing a few minutes after the completion of the previous rotation, appeared entirely credible and was certainly not undermined by the unsubstantiated claim that the money must have passed immediately outside the circle to some initial supplier.
- The transport of the phones to Germany was undertaken by an unknown transport company, and the phones were materially under-insured during transit.
- Notwithstanding the (rare!) contractual term that Cellaway would only pay following inspection, Cellaway appeared to have paid for phones prior to the point at which the phones could have arrived at their destination in Germany, and thus prior to the point when they could have been inspected at their destination. There was also no evidence that the highly improbable (but suggested) position was that Cellaway commissioned an inspection at the point of departure, as opposed to destination.
- There were deficiencies in any inspection of the phones on behalf of the Appellants.
- Without troubling to record the very substantial evidence given by the two experts in relation to legitimate levels of trading in Nokia 8801 and Nokia 8800 phones, we consider first that we prefer the evidence of Mr. Fletcher to that of Mr. Atterbury, but more significantly that the evidence given by both expert witnesses rendered it extremely improbable that the trades in question could have been trades in the legitimate grey market. We find it extraordinary that 28,000 Nokia 8801 phones, not designed for use in Europe, came into the UK with continental European plugs, and then returned to Europe, with purchase orders requesting Eurospec phones (which they were not), with Cellaway paying a higher price for those phones than for the 8800 phones targeted at the European market, all against the backdrop that only 299 Nokia phones were retailed in 22 European countries and the UAE in the entire year 2006 and none in April.
- As an experienced phone trader, and as someone who knew that Carphone Warehouse had rejected a delivery of 8801 phones, we find it extremely unlikely that Mr. Payne would have been ignorant of the reality recorded in the previous bullet point, and believed that trades in 8801 phones could be genuine commercial deals;

- We accept that Mr. Atterbury put his best estimate of the volume of Nokia 8800 phones that might have been expected to be traded in the legitimate grey market in April 2006 at a higher figure than Mr. Fletcher, but we observe that Mr. Fletcher considered that the volume in fact sold represented in his view at least 200% of the total conceivable grey market trading in that model of phone in that period in the relevant European countries. Even on Mr. Atterbury's figures, the figure in fact traded was highly improbable.

154. In conclusion in relation to the April deals, we do not accept Mr. Payne's evidence in relation to the true nature of these deals. When furthermore Mr. Payne was plainly aware of the extent of fraudulent activity in relation to back-to-back dealings in mobile phones and when there were many other features of the April deals that were only consistent with pre-arranged chain transactions in which all parties performed their pre-assigned roles whatever the skimpy documentation said, our conclusion is that the Appellants did have actual knowledge that their deals were connected to fraudulent losses of VAT. Our conclusion is, in other words, not simply that the Appellants must have known that their deals were wholly uncommercial but that they must have known that their deals were connected to fraudulent VAT losses.

General observations that influence our decision in relation to the May and July deals

155. We admit to having found it more difficult to reach our decisions on the "knowledge and means of knowledge" issue in relation to the seven deals undertaken in May and July than we found the decision in relation to the April deals. Once we have concluded, as we have done, that both Appellants had knowingly participated in MTIC deals, the temptation is to conclude that the Appellants are almost bound to have known of the connection to fraud when they subsequently participate in transactions conceded to have been traced to fraud. We do however consider it essential to go a step beyond this, and will now explain why in relation to each of the seven remaining deals we conclude that there was knowing participation in fraudulent deals.

156. Having said that, there are first a number of factors, common to each of the remaining seven deals which support the proposition that the Appellants were knowing participants in MTIC frauds in their role in the last 7 transactions.

157. We first state the point that having concluded that Mr. Payne's evidence was not wholly true, and having concluded that he must have known that the deals with Worldtech were not consistent with genuine deals with a long-trusted (but of course, quite independent) trading partner, we have no basis to accept Mr. Payne's evidence in relation to the faith that he had in Lexus Telecom and Segers Trading. We of course know little about those two entities, but the feature that Lexus Telecom always made fixed margins in the six transactions where it was the supplier tends to throw doubt on its integrity. We know less about Segers Trading and Mr. Richards, but again say that we are hesitant in accepting propositions from Mr. Payne as to their integrity.

158. We next note that there is very considerable relevance to the fact that Mr. Payne and the Appellants had been involved in *bona fide* legitimate grey market trading. They therefore knew, and obviously must have known, the inherent features of transactions of that nature. For instance, it would be almost inconceivable that a supplier would give credit to a purchaser whose own credit standing was poor, without knowing (which would inevitably be the case) whether and to whom the purchaser intended to on-sell the stock. Effort would presumably always have to be made in on-selling stock acquired in genuine deals. Often blocks of stock would be split; often stock would have to be held for some period; and in legitimate transactions whilst purchasers might occasionally have the good fortune to be able to match supplies and on-sales, this would be likely to be the exception. It was reasonably likely, in *bona fide* deals that the identities of either the suppliers or the customers, or usually both, would confirm the genuine nature of the deals. In other words, suppliers might be companies such as those listed in paragraph 4 above (and many other specific companies were mentioned to us in evidence), and customers would often have some coherent standing in the deals. They might, for instance, be retailers, or channels to retailers, in the Third World. In short, *bona fide* deals would involve ordinary trading reality and risks. And experienced grey market traders would find little difficulty in distinguishing between deals where they made fixed profits, with the benefit of supplier-credit for doing absolutely nothing and those deals where they performed a real role.

159. The reality just mentioned leads us to conclude that, while the law makes it clear that we must be satisfied that the Appellants knew or ought to have known that their deals were ***connected to fraud,*** and not that it was ***more likely than not*** that the transactions were so contended, the reality is that for the legitimate grey market traders in relation to which we have already concluded that they knew that they had participated in fraudulent deals in April, there really is in reality no middle ground between obviously genuine deals and MTIC frauds. There is no way, in other words, in which the knowing participant in the April deals, aware of the existence of the widespread nature of MTIC fraud, can claim continuing doubt about the nature of transactions if they are plainly not consistent with their *bona fide* trading.

160. We amplify these points with some comments that will anticipate our decisions in relation to the July deals with Naam Electronics and Sotodelia, in which Mr. Payne said that he was on holiday at the time; that nevertheless he "oversaw" the deals, albeit that in relation to both sets of deals he appeared to know next to nothing, and did not even know how the two suppliers had been identified by the Appellants, or whether indeed the suppliers had conveniently located the Appellants. With these points in mind, we do find it perfectly understandable that with available finance to fund the VAT-gap, and with the Sotodelia deals being effected at the very end of July, Mr. Payne could have sanctioned deals where everything, in the sense of credit, parties, margins and even payment mechanics, appeared to have been put on a plate for the Appellants. It seems obvious that in genuine deals, it would always be essential for the Appellants to locate their own customers, to derive confidence that those customers would pay as promised, and there would generally be more effort involved in on-selling, for instance splitting lots and having to undertake considerable work to on-sell the entire consignment available for purchase. We simply cannot accept that Mr. Payne could have undertaken any work, and any checks along these lines by phone to his own office, when on holiday. Since anyone aware of MTIC

deals in April would have known that MTIC fraud was the only conceivable explanation for deals where everything was put on a plate, and for deals that bore none of the attributes of their own *bona fide* trading, we do reach the conclusion that when the Naam Electronics and Sotodelia deals bore these attributes and could not possibly be deals in ordinary grey market trading, they simply had to be connected to MTIC fraud.

Our decision in relation to the Devi Communications/Trading Point Aps deal

161. We have no hesitation in dismissing the Appeal in relation to this transaction.

162. The fact that Sprint had sufficient information that would have made the possible connection between the supplier and the customer perfectly obvious, and a connection that could easily have been confirmed, indicated that Sprint's involvement made not the slightest sense in the context of any *bona fide* grey market transaction.

163. The fact that without the trading terms being clarified or even mentioned in the purchase orders and invoices, Devi Communications waited to receive the two payments that were funded and immediately paid out of payments from Trading Point Aps until Sprint duly received those payments confirms that the transaction was artificial, and the payment arrangements pre-arranged. Whilst we find supplier credit to be particularly inconsistent with genuine deals (as mentioned above) we find it all the more suspicious when credit is given by a supplier in a completely undocumented manner. When, in the Devi Communications deal, most of the payments were only to be made by Sprint when Devi Communications' own affiliate had first paid Sprint, the absence of any written (or so far as we were told, any other) mention of credit makes it obvious that the reality was too embarrassing to mention.

164. The fact that no party appeared to press for swift payment when the final payment was deferred for approximately seven weeks appears to confirm the supposition that in this deal Sprint was just an artificial insertion into a transaction between two affiliates. When the transaction related to a model of phone whose manufacture ceased in May 2006 it seems odd that the deferral of the release of the phones from Sprint's Ship on Hold constraint subsisted for seven weeks when we are constantly being told how volatile the prices of phones can be. When, however, Sprint's real security lay in the fact that it would presumably on-pay the final balance of Devi Communication's invoice price to Devi Communications only when Trading Point Aps had itself paid the balance owing to Sprint, rather than rely on the Ship to Hold constraint as its security for payment, and when that reality makes the proposition that the two affiliates would have left the phones idle in the consignee's warehouse for the seven-week period dubious, when one was simply paying the other through an irrelevant intermediary, we actually doubt whether the phones did remain idle in the warehouse for seven weeks.

165. We dismiss the Appeal in relation to the 18 May transaction.

Our decision in relation to the Sotodelia deals

166. We have no hesitation in rejecting the Appeals in relation to Sprint's two Sotodelia deals. Beyond the general points mentioned in paragraphs 155 to 160 above, the facts that:

- Sprint paid the "matched" elements of the invoices prices to Lexus Telecom on the same day that Sotodelia made its payments to Sprint;

- the margins made by each party in the circular payment chains exactly equalled the VAT default, such that any contention that the margins were freely negotiated appeared to be exceptionally improbable;

- Sotodelia was a newly formed company ostensibly trading in computer software etc, and not phones at all, and

- the fact that whilst Lexus Telecom alone had no FCIB account, all other parties in the circle, which reverted to Sotodelia, made their payments through FCIB accounts, Sotodelia and five others sharing the same IP address, and two others also sharing a different IP address, rendering it highly improbable that any mastermind could have risked the payments going "off-course", with independent negotiation of supply or deliver by any party,

leave us with no doubt that Sprint knew of the connection of the two Sotodelia deals to VAT fraud. The general points mentioned in paragraphs 155 to 160 above, and at least three of the four points just addressed all impinge on Sprint's "knowledge", and clearly confirm our decision to reject the Appeals in relation to these two claims.

Our decision in relation to the Naam Electronics deals

167. We need to consider our conclusion in relation to the Naam Electronics deals by referring also to some of the facts in relation to the May deals with Cetro Tek Holdings, because it appears that there were similarities. In particular, the supplier in all four deals was Lexus Telecom, Segers Trading was mentioned in the documentation in relation to all the deals, as some sort of introducer in relation to the Cetro Tek deals, and wrongly as a consignee in relation to the Naam Electronics deals. Far more relevantly, the FCIB evidence strongly suggested that the money in all four deals ended up with Segers Trading.

168. It is unappealing to base a decision on suspicion, when we accept that no evidence was given or sought from Segers Trading, but it certainly appears that Segers Trading had a significant role in relation to all of these deals. Whilst Segers Trading did not openly assert, when indicating to the Appellants that Cetro Tek was looking for stock, that the stock in question was stock of the description that Segers Trading actually held, it does very much look, when the ultimate payments ended up with Segers Trading, that Segers Trading must have in some way both provided the stock and effectively been involved in putting both deals together. That would account for the commission notion in the Cetro Tek deals and the way in which Segers Trading was referred to, wrongly it was said, as the consignee in relation to the Naam Electronics deals.

169. Without asserting that we can reach a conclusion as to precisely what happened in these four deals, we certainly note that MTIC fraud does not require circularity, and it is perfectly feasible for Segers Trading to note that if it might otherwise trade directly with Cetro Tek Holdings and Naam Electronics, it can enhance its profits if it arranges for the phones to be sold indirectly through the UK, with the rewards to the buffers and the exporter being materially less than the VAT

recovered. That is a possibility and we cannot put it any higher than that. With the Respondents, however, we certainly note (in particular in relation to the Cetro Tek deal, but in reality in relation to both) that if Segers Trading held stock which was destined for each of Cetro Tek Holdings and Naam Electronics (and the fact that it received the payments in all four deals appears to confirm that supposition), MTIC fraud apart, it is difficult to see why in genuine grey market trading, Segers Trading would not simply have sold directly to the Appellants' customers.

170. Our decision in relation to the Naam Electronics deals is that the Appeals in relation to them are dismissed. When Mr. Payne knew nothing about those deals it is perhaps not surprising that we cannot articulate the best of reasons for our decision, but in summary, we base the decision on:

- the points mentioned in paragraphs 155 to 160 and the improbability of Mr. Payne having been able to negotiate genuine grey market deals, as opposed to deals that were put on a plate for him, while on holiday;

- a total lack of confidence in Mr. Payne's claims of total reliance on Lexus Telecom and Segers Trading;

- the apparent role of Segers Trading, whose role (whatever it actually was) certainly emerged in the Appellants' paperwork in both deals;

- the chaotic unprofessional way in which the Naam Electronics deal was implemented (mentioned in the middle bullet point in paragraph 114 above);

- and the fact that a deal implemented on the very last days of the month happened to match quantities and models, and bear many of the other common attributes of MTIC trading, rather than genuine deals.

Our decision in relation to the two May deals with Cetro Tek Holdings

171. While we have already noted that there were similaries between the Cetro Tek deals and the Naam Electronics deals, there are further points to address in relation to the former.

172. We first make the obvious point that we cannot adopt one of the common approaches of the Respondents in relation to MTIC appeals and support the rejection of an appeal because whatever the chaotic documentation might have said, the parties were nevertheless obviously confident that they would in fact get paid and they did get paid. Because in the case of the Cetro Tek deals, we accept the evidence that most of the price was not paid. This does not of itself indicate that the deals were not connected to VAT fraud. It is perfectly possible in theory that Segers Trading might have been about to sell directly to Cetro Tek Holdings, whereupon it would have been Segers Trading that would have hit the problems, whatever they were, in relation to Chinese exchange control, and they might have suffered the bad debts. Having then switched the deal to filter through the UK, it became the Appellants that suffered the bad debts, but that fact of itself does not undermine the Respondents' MTIC claims. The non-payment is, in other words, a very unusual attribute of an MTIC deal, or of an efficiently planned MTIC deal, but non-payment certainly does not undermine the Respondents' case.

173. The next point that we make is that we were totally unmoved by a strenuous argument on the part of the Respondents geared to the fact that Mr. Payne considered the possibility of re-invoicing the Cetro-Tek deals in the way requested by Mr. Housefield. To amplify this point, though this is in the event not particularly important, it sounded as if there were two possible ways of re-invoicing the transaction that might have enabled Mr. Housefield to pay what was owed. One seemed to involve asserting that some other phones had been sold, whereupon those fictitious phones would have been invoiced in quantities and values that would have fallen below whatever threshold precluded payment of the original invoices. This of course would have been somewhat devious. It appeared however that another possibility was simply to issue a credit note, cancelling out the original invoices, whereupon new invoices would be issued, quoting slightly lower prices for the phones, augmented then by some sort of undefined fee that would leave a total charge equal to the original invoice amounts plus 2% for late payment.

174. We are not particularly interested in the detail of this because it all seems to us to be irrelevant. We might first say that insofar as it had any relevance, that relevance was doubtless to indicate that Mr. Payne was prepared to consider embarking on suspect invoicing. If this was the point, two comments on that appear to be that he refrained in the end from issuing any of the requested paperwork and, had he not done so, he would certainly not have been the first reasonably honest person to prepare the wording of invoices to achieve some important point for one of the parties.

175. The far more relevant point, however, is that everything in relation to the battle to receive payment all occurred well after the deals were implemented, and after the critical time point on which we must be concentrating, namely the point when the deals were done, at which point we must consider whether or not at that point the Appellants knew of the connection to fraud. If we were meant to doubt Mr. Payne's honesty then, as the Respondents themselves pointed out, there were many other matters that put that honesty into serious question, far more obviously than this business about seeking to obtain payment.

176. The point just made about timing reveals however that the whole point about the non-payment is actually totally irrelevant in this appeal. Non-payment might in other circumstances be claimed to be a factor that might undermine even the connection of a deal to VAT fraud, or it might render VAT fraud unlikely in the first place. In this case, i.e. the Cetro Tek Holdings deals, the Appellants have conceded connection to VAT fraud, and all the circumstances of the movement of the goods through five buffer companies, all at typical margins, seem to confirm that that concession was entirely realistic. There was, thus VAT fraud in these two deals. The only remaining question is the state of mind of the Appellants when the deals were done, and it seems to us that the fact that the purchaser ultimately failed to pay for the goods (obviously after the deals were done) has absolutely nothing to do with that state of mind.

177. Once we reach that conclusion, it appears to us that the Cetro Tek Holdings deals are effectively identical to the Naam Electronics deals. Although in May Mr.

Payne was not on holiday, it appears that the deals were not arranged that much more efficiently because the goods were released without payment having been received. The reality nevertheless was that the Appellants were being introduced to deals by Segers Trading that appeared to be somewhere in the non-UK side of the supply line; Segers Trading obviously knew of Cetro Tek Holdings and could have supplied directly to them; in fact they chose to introduce the deal to the Appellants and that sort of deal looks very much more like an MTIC deal than a genuine one. to someone who has just implemented ten deals that must have involved knowledge of the connection to fraud. Mr. Payne, knowledgeable as he was of the attributes of genuine deals, must have been aware of this.

178. We accordingly decide that these two final cases also involved knowledge, and that the whole Appeal by each Appellant should be dismissed.

Costs

179. We do not believe that the Respondents applied for their costs, if successful, and since the Appeal was commenced when the old costs regime was in place, and since we are unclear whether any earlier Direction was made in relation to costs, we make no order in relation to costs at this stage.

Right of Appeal

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

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 5 December 2012