TC04090

Appeal number: LON/2007/01648

Value Added Tax - MTIC appeal - Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

HONEYTEL LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE HOWARD M. NOWLAN
MR JOHN ROBINSON

Sitting in public at 45 Bedford Square in London on 23 June to 3 July and 9 July 2014

Declan Mundy, director of Honeytel Limited on behalf of the Appellant in person

Christopher Foulkes, counsel, instructed by Howes, Percival LLP, on behalf of the Respondents

DECISION

Introduction

1. This was a relatively simple Missing Trader or MTIC appeal in that it involved only two deals, both undertaken on 28 April 2006. The Appellant had undertaken many deals before the two that were challenged, many of which had similar attributes to those that were challenged in the Appeal before us. We, however, are only concerned with the two.

2. The deals involved the acquisition of three batches of mobile phones, Nokia N70s, N90s and Nokia 8860s. The total VAT inclusive purchase price paid by the Appellant for the phones was £5,702,046. It was contended by the Respondents and accepted by the Appellant that it was now clear that all had been purchased directly from a large-scale contra-trader, namely Demravale Limited ("Demravale"). The Appellant had then sold some of each of the relevant phone models to an existing customer which we will refer to as "Pro-Choice", a Portugese company based in Madeira, and the remainder to a new customer, registered for VAT purposes on only 2 February 2006, namely a Spanish company that we will refer to as "Rachaeltel".

3. Although we have referred in paragraph 2 to acquisitions and sales of the phones, some evidence suggested that the phones had not been transported to their purported destinations in the manner claimed, such that there was considerable doubt as to whether the phones had ever existed. In this context, some of the directors of Demravale, and the relevant freight forwarder, that we will refer to as "Coast", had been imprisoned for fraud occasioning losses to the exchequer. HMRC had challenged the claims for input recovery on conventional *Kittel* lines however, and not strictly on the basis that there had been no acquisitions and supplies. The doubts about the existence of the phones were simply advanced as factors supporting the claim that the Appellant's attention to the reality of the deals, and diligence in checking the existence and onward delivery of the phones was severely lacking.

4. The Appeal raised essentially two issues.

5. The first was based on largely unchallenged HMRC evidence to the effect that numerous deal logs appeared to indicate that there was one controlling mind behind numerous companies and deals, involving various identified non-UK suppliers, contra-traders, exporters or brokers, and foreign customers. Altogether these deals seemed to involve 5 contra-traders, five exporters or brokers, and 10 candidate foreign purchasers. The claim (not disputed by the Appellant) was that there was every indication that some mastermind was ringing the changes, arranging various deals but switching the identity of defaulters, contra-traders, exporters and foreign customers, but generally using companies for each role from the relatively short lists just indicated. Since this feature, and the same impression given by the evidence of banking payments obtained from the accounts of First Curacao International Bank ("FCIB") all suggested that every step in the deals was pre-arranged and planned, the strong contention on the part of the Respondents was that the Appellant must have been a knowing party to the transactions and their objective. The Appellant denied this, and claimed that not only did it not know of the connection to fraud, or how indeed some mastermind had managed to insert the Appellant in the crucial role between the supplier and customers, all as plainly required for the planning to achieve its object, but also that, having taken all the precautions recommended by HMRC, there was no way in which it "could" or "ought to have known" of the connection to fraud.

6. The alternative, and very secondary contention made by the Respondents, albeit that it was also advanced in a very thorough manner, was that the Appellant had not taken the role that HMRC expected it to take, of seeking to ensure that its deals were legitimate deals, not connected to fraud, remotely seriously or intelligently. The Respondents contended either that the Appellant's real attention to seeking to verify that its suppliers and customers were legitimate was extremely lax, or indeed that after the ECJ's decision in the *Bondhouse* case in January 2006, the Appellant was amongst the numerous traders who thought that they could ensure safe recovery of VAT on dubious exportations, merely by producing paperwork feigning due diligence, and by making "Redhill" checks, to ensure that their suppliers and customers were validly registered. On either of these bases it was claimed that at the very least the Appellant "ought to have known", from facts perfectly evident from a remotely critical look at the evidence before it, that there could be no other explanation for its deals than that they were connected to fraudulent VAT losses.

7. We should finally mention in this Introduction that great stress was placed by the Appellant on indications that they claimed to have had, and indeed appeared to have had, from their previous VAT officer, a Mr. Rowe, that their due diligence was reasonably satisfactory. They also claimed to have relied on the fact that many earlier deals had been approved, and VAT reclaims duly met by HMRC notwithstanding that the parties to those deals had been the same, Rachaeltel apart, as the parties involved in the challenged deals.

7. Our decision is nevertheless that the Respondents prevail on both the grounds summarised in paragraphs 5 and 6 above, and that this Appeal is dismissed.

The evidence

8. Very considerable evidence was given in this Appeal. Since, however, the Appellant now accepted that its direct supplier, Demravale, with which it had traded for at least three years, turned out to have been a fraudulent contra-trader, it was unnecessary to hear those witnesses who had delivered witness statements in relation to the ultimate defaulters. Furthermore there were no buffer companies and so no evidence about tracing through buffer companies. The evidence given by the case officer for this appeal, Mr. Simon Zaater ("Mr. Zaater") was largely factual and uncontentious and we will summarise the material points in dealing with the facts below. The only other witness for the Respondents, to whose evidence we will need to give particular attention, was Mr. Nigel Humphries ("Mr. Humphries"), the officer who had compiled the evidence in relation to the apparently similar deals conducted by the 5 contra-traders, the 5 brokers and exporters and generally the 10 foreign customers to which we made a brief reference in paragraph 5 above. There was considerable FCIB evidence but since the conclusion suggested in relation to that evidence was accepted by the Appellant, it was unnecessary for Mr.Mendes, who had compiled the FCIB evidence, to give evidence in person or to be cross-examined. The relevant conclusion in relation to the FCIB evidence was that the payment chains in the challenged deals had been circular, and that pre-arranged payments seemed to involve not only the deals to which the Appellant had been a party, but those other deals under which Demravale purchased on a VAT-inclusive basis and then itself exported to the same foreign customers on Mr. Humphries' list (i.e. therefore, the other side of the contra-trader's matched deals).

9. Evidence was given by three witnesses on behalf of the Appellant. The principal witness was Mr. Declan Mundy, who we will refer to as "Declan Mundy" throughout this

decision. Evidence was also given by Declan Mundy's father, "Nick Mundy", and by the other director of the Appellant, namely Mr. Russell Hughes ("Mr. Hughes"). We will summarise much of the evidence given by the three witnesses for the Appellant in giving the facts. While we will defer recording particular elements of the evidence given by Declan Mundy and Mr. Hughes until later, we will now make one matter clear in relation to Mr. Hughes and his evidence.

10 . While Declan Mundy and Nick Mundy were present for the early days of the hearing (and Declan Mundy of course for the entire hearing since he appeared as advocate as well as witness), Mr. Hughes did not appear until the first day on which he was to give evidence. It was then explained that he had suffered some heart problems, and that at present he was suffering considerable pain and lack of mobility on account of knee and hip problems. It was perfectly clear that he was in considerable discomfort. Mr. Hughes was then in the witness box for the entire day. Much of the cross-examination was fairly fraught, in a manner that we will describe reasonably fully once many of the surrounding facts have been revealed. In short, however, there were occasions when Mr. Hughes ended up giving conflicting evidence, and having to concede that some of his assertions had been unjustified. There was also repeated criticism of the Respondents' extremely competent and very fair counsel, along the lines that he was not a businessman and did not understand the realities of business.

11. Although Mr. Hughes was due to give further evidence on the following day, and indeed was about to be cross-examined on the crucial evidence of his individual role in locating the three parties to the only deals with which we were concerned, Mr. Hughes was not in court when the court convened, and we were told that he had been driven back on the previous evening to Sunderland in the north-east of England where he lived, in order that he could consult his doctor. While it was not immediately certain that he would be unable to attend the hearing in future or to complete his evidence on behalf of the Appellant at some adjourned hearing, we were told verbally that his doctor considered that he would not be in a fit state to attend the hearing for the next two weeks. When we were shown the actual letter from the doctor this referred to his knee and hip pain and to the fact that the pain killers he was given for those disabilities caused him to be drowsy. We will defer our conclusions in relation to his evidence until the decision paragraphs below, but in the meantime simply record that Mr. Hughes never reappeared and Declan Mundy said that he, Declan Mundy, was content not to ask for an adjournment so that Mr. Hughes could continue and complete his evidence and his cross-examination.

The facts in more detail

Background to the formation of Honeytel Limited

The Evolink period

12. Prior to either 1999 or 2000 Declan Mundy had worked in the travel and hotel industry, dealing with numerous travel agents and travelling abroad, presumably checking out different hotels and resorts. He was tiring of this work and the constant travel and therefore happily took up the offer of employment with a company owned and operated by one of his brothers, Ciaran Mundy, together with a Mr. Dominic Neate. The company was called something like Evolink, or Evolink and Elise ("Evolink") (named we were told after the Mitsubishi Evo and the Lotus Elise) and it traded as a wholesale trader in mobile phones. Prior to taking up

the offered position at Evolink, Declan Mundy had had no experience in relation to mobile phones and certainly none in relation to the wholesale trading in mobile phones.

13. It appeared that Nick Mundy, a retired civil servant who had worked in the Ministry of Defence, had performed some roles in relation to Evolink in that he had re-mortgaged his house and provided loan finance to Evolink, and he may well also have performed the function that he came later to undertake for the Appellant, namely that of acting as book-keeper and dealing with routine payments of rent, salaries etc.

14. Declan Mundy was trained in how to deal with wholesale trading in mobile phones by the existing directors of Evolink. We are not particularly concerned with the activities at Evolink but it was clear that the existing directors had both a rolodex that contained contact and perhaps other details of suppliers and customers, and also templates for the sort of documentation that was required to effect back-to-back wholesale deals, once the claimed calls from or to customers and suppliers had identified a deal in which Evolink could purchase phones, export them, and on recovering the input VAT, make a profit.

15. Declan Mundy worked for Evolink, on a commission basis, for approximately two years. Towards the end of that period, his brother and Mr. Neate were dedicating more and more of their time to biological research, and paying less attention to the trading at Evolink, and both Nick Mundy and Declan Mundy were beginning to fall out with Mr. Neate. As a result, Nick Mundy withdrew his loan funding from Evolink, and Declan Mundy ceased to work for Evolink.

16. Before leaving Evolink, which is now otherwise irrelevant to this Appeal, we should mention that while trading at Evolink, Declan Mundy had dealt with, and had got on well with Mr. Hughes. We were never entirely clear of the role that Mr. Hughes had performed in relation to Evolink, or indeed the precise role that he performed once he became a joint shareholder and director of the Appellant. As regards Evolink, it appears that he offered deals on a commission basis, and was not therefore either an actual supplier to, or customer from, Evolink. Whether he offered matched deals or simply presented possible offers of stock or demands for stock, leaving it to Evolink and Declan Mundy to deal with the required matching of a purchase order to an export sale, or *vice versa*, we were not told. Whatever his role, he and Declan Mundy got on well, and when Declan Mundy was contemplating pulling out of Evolink, and Nick Mundy was contemplating withdrawing his loan finance, Declan Mundy and Mr. Hughes took the decision to set up the Appellant together.

The formation of the Appellant

17. When the Appellant was formed in July 2002, the 200 shares were divided such that Declan Mundy and Nick Mundy owned 99 and 1 shares respectively and Mr. Hughes owned 100 shares. Nick Mundy clearly understood that the essence of the trading in buying mobile phones on a VAT-inclusive basis from UK suppliers and exporting them was a trading pattern that required working capital in that even if the traditional terms of trade "in the industry" as the parties described it, always involved each trader's supplier having to be paid only when that trader's customer (i.e. generally an export customer in the case of the Appellant) had first paid the Appellant, the payment to the supplier would inevitably require working capital since it would be for more (on a VAT-inclusive basis) than the price received on a VAT-exclusive basis from the non-UK customer. The deals would nevertheless be profitable provided that the claims made, following the export sales, for the repayment of the

input VAT were duly met by HMRC. Pending such repayments, which generally took approximately a month from the date when VAT returns and repayment claims were made, working capital was required to fund the balance of the payments made to the suppliers.

18. With this cash-flow requirement in mind, we understand that, having withdrawn his loans from Evolink, Nick Mundy advanced £350,000 to the Appellant; both Declan Mundy and Mr. Russell were said to have had some savings, such that each of them advanced about £80,000 to the Appellant and, without our ever being told any of the detail, other family members were said also to have made advances to the Appellant.

19. The Appellant sought registration for VAT purposes in February 2002, and in responding to the question on the registration form in relation to its likely turnover, Nick Mundy, who completed the relevant form, indicated that the expected export turnover would be £75,000,000 annually. It seemed to be accepted that this figure, which actually appeared twice on the form, was not meant to be £75 million but either £75,000 or £750,000. Nothing hinges on which might have been intended, but it was suggested that the latter amount was intended, though the lower amount of £75,000 seems more realistic since it was a figure intended to illustrate that the turnover was expected to be above the registration threshold.

20. When Declan Mundy left Evolink, he took with him the rolodex that contained all of Evolink's contact details for suppliers and customers, and the templates, or drafts for transaction documentation. The Respondents' counsel asked Declan Mundy whether his brother and Mr. Neate objected to his taking all of such details and draft terms, and the answer seemed to be that his brother was not enthusiastic but nevertheless raised no serious objection. Declan Mundy also said that there were hundreds of traders and that there was nothing particularly confidential about their identities. Whatever the detail of this, the Appellant clearly had all the relevant contacts, and the templates, and since by then Declan Mundy was thoroughly familiar with "doing the deals" and his father was ready not just to invest the loan capital, but to assist again in doing the book-keeping, the Appellant was ready to trade.

21. It seems that it was always accepted that Declan Mundy alone would attend to documenting the deals and operating and (if needed) staffing the office, initially in the shed behind his house in London Mr. Hughes would continue to live in Sunderland. In the early period of the trading of the Appellant, Declan Mundy appreciated that Mr. Hughes was going to have to attend to the business of running down his previous business called One-stop Phone Shop Limited. We were never entirely clear as to the business of that company but it certainly started as predominantly a small retail shop, but may have branched into wholesale trading. But even when that trade had been wound down, it seems that it would remain the intention that Mr. Hughes' role was to be one that would never involve him in the production of documentation, or presumably the undertaking of the various checks that the Appellant was expected to attend to, or any other roles that would involve him in moving to London. Accordingly, Mr. Hughes' role would inherently be confined to ringing round and trying to arrange deals, and if and when he succeeded in so doing, the deals would then be processed by Declan Mundy in the London office.

22. Declan Mundy was assisted in dealing with the trading, the communication with suppliers and customers, and with matters such as HMRC's Dorset House or Redhill VAT registration checks by a good friend who he trusted, namely Sheila Sheehan ("Sheila").

Sheila regrettably died, and Declan Mundy's efforts to replace her were all unsuccessful, so that Declan Mundy ended up doing the documentation of deals on his own. Nick Mundy's evidence had been that his role had largely been confined to giving a bit of help on an emergency basis when something needed attending to. He certainly spent a considerable time in checking the existence of, and correct details of, mobile phones at freight forwarders' premises in the early period (along with two others who also assisted in this role, one of them being another of Nick Mundy's sons), but as we will describe that role soon ceased. Whilst we had not particularly gathered this from Nick Mundy's evidence, we learnt from Declan Mundy that his father always dealt with the book-keeping, and the various payments for rent, staff, and the money movements through the Appellant's Barclays account. He had nothing to do with the trading, or the FCIB payments in relation to the deals, but otherwise dealt with all the book-keeping matters.

23. When the Appellant commenced its business in late 2002, Declan Mundy claimed that he was oblivious to the existence of MTIC fraud, and had certainly had no guidance from HMRC officers as to the checks that the Appellant should be conducting, and no indication from HMRC officers as to why they said that such checks were crucial. We were not told to what extent the template documentation taken from Evolink extended to due diligence checks. Nick Mundy certainly understood, as did all involved, that the pattern of trading was going to require working capital and that the great majority of deals would involve exports and resultant claims for the repayment of VAT but we did not conclude that Nick Mundy or, certainly at the outset, Declan Mundy, were aware that this pattern of trading indicated, or might be any sort of indication, that the trading was fraudulent. It is possible that Declan Mundy might have had some expectation of the need to pay great attention to the credibility of trading partners, but it is irrelevant for the purposes of this Appeal to reach any decision as to whether at the outset he did or did not appreciate the potentially risky area in which he was trading.

24. We were not given details of the relatively modest level of trading in the early period of 2002 and the early months of 2003 prior to the month of April. We certainly know that by April 2003, the Appellant had been given some MTIC warnings and had been notified that several of the companies, whose VAT-registration details the Appellant had checked with HMRC, had in fact subsequently been de-registered. Declan Mundy could not generally remember whether the companies of whose de-registration the Appellant had been notified were companies with which the Appellant had proceeded to undertake deals after checking their VAT registrations. The Respondents' counsel asked Declan Mundy whether he appreciated that he had either done, or come close to doing, a deal with a party that might either then (or perhaps somewhat later) have been connected to MTIC fraud, and whether he was either relieved to have escaped such involvement or realised that he must improve his scrutiny of trading partners in future. There was no particularly notable response to such questions, other perhaps than the general statement that the Appellant was doing, and would continue to do, everything that HMRC requested in relation to verification.

25. Another matter to which we should refer in relation to the early trading in 2002 and up to April 2003, is that in order to accelerate its ability to finance more export sales prior to actually receiving repayments of VAT from HMRC, the Appellant factored its receivables from HMRC with Barclays Bank. Apparently Barclays Bank required PKF LLP, the large accounting firm, to look into the pattern of trading by the Appellant before granting this facility. When negotiated it provided for the Appellant to receive from Barclays 85% of the receivables from HMRC on the basis that were HMRC to decline repayment then the

Appellant would remain liable to Barclays to pay the full amount of the relevant receivable. We were told that this facility lapsed after the introduction of joint and several liability, to which we now turn, so in other words that it dealt only with the trading up to April 2003.

26. Between April and August 2003, the Appellant undertook no transactions because it learnt that there was a consultation process in relation to the introduction of the joint and several liability rules under which parties that sold goods in taxable transactions in relation to mobile phones and CPUs might have joint and several liability for the VAT unpaid by previous traders in a chain when one of such traders had failed to pay the VAT owing, if the later trader either knew or ought to have known of such non-payment.

27. In May 2003, Declan Mundy wrote to HMRC, requesting a meeting, and after saying that the Appellant supported action to stop fraud, asked, in relation to potential joint and several liability:

> *"If company A has taken all the appropriate steps to ensure that the supplier and customer are bona fide and the goods are real and reasonably priced but further back in the supply chain you then discover there are potential problems, we assume company A will not be jointly and severally liable."*

The HMRC officer's response to the question, in a letter of 2 September 2003, was:

> *"If a business genuinely does everything it can to check the integrity of the supply chain, can demonstrate it has done so, takes heed of any indications that VAT may go unpaid and has no other reason to suspect that the VAT would go unpaid then Customs will not apply the measure to that business".*

28. Other points that Declan Mundy asserted, in response to questions raised in the consultation process prior to the introduction of joint and several liability, were that the Appellant always checked the supplier and customer VAT details, including VAT number, address and banking details, with Dorset house on every occasion a transaction was done; that the Appellant only used "*reputable freight forwarders and always insured own goods in transit"*, having at the time "*copies of freight forwarder insurance documents";* that the Appellant was thinking of acquiring a scanner to inspect all IMEI numbers, and that "*we spend 2-4 hours every day doing our checks and will continue to do so as long as there is any possibility of fraud in the business."*

29. We will revert, in giving our Decision, to the significance of the exchange of the question and answer recorded in paragraph 27 above, and to the respect that the Appellant was adhering to the claims just recorded in paragraph 28 above when undertaking the deal or deals challenged by HMRC in this Appeal.

30. In a letter of 29 May, sent after the letter from which the quotations were taken in paragraphs 27 and 28 above, Declan Mundy informed HMRC that due to the uncertainty in the market occasioned by the proposed introduction of joint and several liability, the Appellant had temporarily had to suspend trading, had laid off two employees (presumably the brother and the other man who assisted Nick Mundy in checking phones), and had decided not to buy the once proposed scanner.

31. It was claimed that the Appellant had also been told by HMRC officers that it was preferable for checks at freight forwarders' warehouses to be undertaken by independent companies, rather than by the Appellant's own employees. Whether the Appellant's checkers were laid off because of the claimed reduced margins and in particular the temporary suspension of trading between April and August 2003 or because of the preference, allegedly suggested by HMRC, that checking be done by independent companies, we were never clear. Whatever occasioned the result, the result was in fact that the Appellant ceased to deal with its own checking. We might mention that the level of checking that Nick Mundy had described had been quite extraordinarily thorough in that he even referred to opening all the retail boxes and checking for batteries and every detail. Whilst that appears to have been unusual and perhaps excessive, in-house checking obviously ceased, and we will have to revert later to the standard of independent checking undertaken by the freight forwarders used on the challenged deals.

32. Trading resumed in August 2003, and we were told that it appeared to be conducted in a similar manner to the trading up to April. There was certainly correspondence with HMRC in which the Appellant was suggesting that if it took details of all IMEI numbers to enable HMRC to check them against a database of all movements of mobile phones, this might assist in stopping fraud. Beyond that there continued to be occasions when HMRC notified the Appellant of the de-registration of some trader, for which the Appellant would have sought to check valid VAT numbers in the recent past.

33. In fairness to the Appellant, we should also record that the Appellant appeared to have had relatively good relations with its own VAT officer, Mr. John Rowe ("Mr. Rowe"). Mr. Rowe did not give evidence before us, and the Appellant certainly claimed that insufficient regard was paid by HMRC, when deciding to refuse the repayment of the VAT involved in its April 2006 deals, to the various facts that:

- Mr. Rowe had generally been satisfied with the documentation produced by the Appellant, and with its VAT checks;
- while Mr. Rowe may have suggested that 100% rather than 10% IMEI checks would be preferable, the general impression gained by the Appellant was that Mr. Rowe considered the Appellant to be more compliant and cooperative than many other traders; and
- it was particularly odd and inexplicable that the Appellant's return for the period 04/06 was being subjected to the new much more extensive standard of "extended verification" only introduced in early 2006 when the Appellant's deal in late March 2006, involving the same parties as the April 2006 deals, had been cleared (albeit on a "without prejudice" basis) by Mr. Rowe.

The contested deal or deals largely documented on 28 April 2006

34. As we indicated in paragraph 2 above, the Appellant's deals in April 2006 consisted simply of the deals documented on 28 April, in which large quantities of the three models of Nokia phones that we mentioned in paragraph 2 were purchased from Demravale, the supplier with which the Appellant had traded for at least 3 years. The phones of each category were then split and sold to either the Portuguese company with which the Appellant had traded before, namely Pro-Choice, or to the new customer, the Spanish company Rachaeltel. The percentage profit margins made by the Appellant, assuming the recovery of VAT (not only in respect of these deals but in respect also of the deals conducted with

Demravale in February and March 2006) were all in the range from 5.5% to 6.9%. In the case of the supplies made in the April 2006 challenged deals, the unit prices paid by the two different customers were the same for each model of phone acquired.

35. The total VAT reclaimed in respect of these transactions was the substantial sum of £851,924. Further very small amounts of reclaimed input tax were also refused. These related to charges by the freight forwarder, Coast, that had been used by Demravale on the April deals, the deals undertaken on the last few days of the previous month of March and two deals undertaken at the end of May and June respectively. The input tax in relation to the freight charges was refused because in the case of the April deal, there was significant evidence that the goods had never existed, and so plainly cannot have either been stored or transported. In the case of the May and June deals, they were either cancelled or reversed once the Appellant realised that the April deals were to be subjected to extended verification, it never being clear whether they were cancelled prior to or after any claimed despatch of the goods. On the reasoning, again, that the Appellant could not establish that the goods on either occasion had in fact been stored and transported, the claims for the repayment of VAT input tax in relation to freight forwarders' charges for these periods were also refused.

36. The purchase orders for the purchase of all three models of phone sent to Demravale by the Appellant were all dated 28 April, and save for the differences in actual model number of Nokia phone on each, they were otherwise in identical terms. The product description of those for the Nokia 6680 phones said:

> *"Nokia 6680 Original Nokia Stock, Never Previously Locked, Sim Free and Original Central Euopean Software. Two Pin Plug. No Label. Made in Finland"*

The only other term on the purchase orders was:

> *"Payment made after Satisfactory Inspection and Invoice Received"*.

37. The related invoices from Demravale were also dated 28 April, but where they were shown, the fax dates recorded on the invoices were for 2 April 2006. Declan Mundy asserted that Demravale's fax dates were always wrongly set. Beyond that, the product description and the terms were again the same for all three categories of phone, the relevant description and terms being as follows:

> *"Brand new, Retail Boxed, Full international documentation. All package contents cables, manuals etc No stamps or labes other than original.*
>
> *Terms and Conditions*
>
> *Title in goods will remain with vendor until payment has been received in full.*
> *Any discrepancies with the above stock must be notified before payment.*
> *Demravale Limited will accept no liability after this period.*
> *Bank Details to follow"*

38. On the supply side of the challenged transactions, Pro-Choice's purchase order was also dated 28 April, but the fax header on the order was dated 3 May. The description of the three categories of phone was always the same, in the following terms:

"All Central Euro spec, European manual, new and SIM Free and in original box only"

accompanied by the only following term, *"Same day payment"*.

39. The Appellant's invoice to Pro-choice, again dated 28 April, contained no description of the specification of the phones, other than just the model number. The only terms mentioned were:

"Same day value payment must be made after inspection. Goods will only be released on receipt of full payment."

40. Rachaeltel's corresponding purchase order and the matching invoice from the Appellant were again both dated 28 April, but neither contained any description other than the simple model number of the three models of phone. The Appellant's invoice included the words:

"Same day value payment must be made after inspection. Goods will only be released on receipt of full payment."

41. The Appellant's Inspection and Release/Allocation instruction to Coast, where of course the goods were already held (if, at least, they existed), was also dated 28 April. The CMR documentation suggested that the goods were not actually despatched until 8 May. The instruction to inspect the goods was very strange because it simply referred to *"Inspect[ing] these goods. 10% only"*, but it gave no description of the goods other than the model numbers. The inspection report from Coast appeared not to have been dated but contained a fax date of 18 May. The Appellant indeed said that Coast were always late with their paperwork. More significantly, the report seemed to confirm that the phones had been 100% checked and counted, and then gave details of the Yes/No results to the inspection of the following matters, namely Quantity, Manufacturer, Model, Colour, Battery Type, Battery Capacity, Battery Code, Plug type, Manual Language, and Country of Origin. The word "No" was deleted against every item of specification just listed. It seemed distinctly odd to confirm "Yes" in relation to colour, when no document had ever indicated the colour of the phones, and odd to say "Yes" to items such as the battery type. Plainly if no details of the expected specification of the phones had been mentioned by anyone, the answer "Yes" was meaningless.

42. We have already alluded to the point that HMRC contended that the phones had never been despatched, and that indeed they had never actually existed. The basis for this claim was that, although the registration number of the lorry that had purportedly delivered the phones was given on the CMR, the lorry was in fact a breakdown truck whose driver had never heard of Coast or delivered mobile phones. Other quite separate CMRs suggested that the same lorry had simultaneously carried numerous other pallets of mobile phones, such that the total quantity of pallets and phones ostensibly delivered could not possibly have been carried on the lorry in question on one occasion, as suggested by the CMRs. We are not required to reach any decision as to whether the phones had or had not existed, since HMRC were advancing their main case on *Kittel* lines and not on the basis that the goods had not existed. We simply accept HMRC's point that, had the Appellant visited Coast's premises, they might have detected that the phones did not exist. For the purposes of the minor refusal to refund the input tax in relation to Coast's own services, we note that since HMRC's

evidence concerning non-delivery was not disputed by the Appellant and since the Coast directors had been imprisoned, it appeared reasonable to conclude (in relation to the claim for input deductions in relation to Coast's charges), that the Appellant had failed to establish on the balance of probability that the phones had existed, been stored by Coast and despatched. Certainly no explanation had been volunteered for any of the factors said to throw doubt on the existence of the phones.

43. One other fact to which we will revert below is that it appears that although the Appellant asserted that it had always insured goods, and asserted that it had instructed Coast, and indeed all other freight forwarders, to insure the goods, they had in fact not been insured.

The extended verification of the April deals

44. Mr. Zaater's first involvement with the Appellant was to be given the task of undertaking the extended verification of the Appellant's April deals. He told the Appellant that he would be undertaking this task in July 2006, and informed the Appellant in August 2007 that the repayment claimed by the Appellant for the period 04/06 was being refused on the basis that it was connected to VAT fraud, and that the Appellant knew or ought to have known that this was so.

The relevant facts in relation to Demravale, the contra-trader, that sold to the Appellant

45. HMRC had been investigating the affairs of Demravale since January 2006, but it appears that HMRC were not in a position to de-register Demravale until July 2006. We are not going to refer to any of the evidence in relation to Demravale because we consider it to be clear that it was acting, in relation to the Appellant's April 2006 deal, as a fraudulent contra-trader. Virtually any reader of this decision will be familiar with the fact that the activity of a contra-trader was to purchase various very large quantities of MTIC-style goods from a UK chain at the origin of which there would have been defaults in paying the VAT due when the products had been imported. The contra-trader would then export those goods, a step that would ordinarily occasion a repayment claim for input VAT, which (particularly because of the vast quantity of the deals usually involved in contra-trading) might well attract scrutiny on the part of HMRC. Rather than reclaim the relevant VAT, therefore, the contra-trader purchased from European suppliers broadly equivalent quantities of MTIC-style goods on a VAT-exclusive basis, in respect of which it would ordinarily have had to account for VAT when selling the goods to a UK dealer. The trick of the contra-trader was thus neither to reclaim the VAT in respect of its export transactions, nor to account for VAT in respect of its equally vast imports and on-sales to domestic buyers, but to assume (as would be the case with non-fraudulent deals) that it was proper to offset its own liability for VAT on its imports and its domestic sales, with its entitlement to repayments derived from its export deals. Invariably the contra-trader ended up at the end of its three-monthly VAT period (the usual length of the 3-month period being designed to defer the date when HMRC would have the slightest idea of the deals that had been undertaken) with a return indicating either a fairly modest net liability or an equally modest net repayment claim. The domestic buyer that had purchased the goods from the contra-trader (i.e. the Appellant in this case) would then export the goods and it was perceived that the risks of detection of the fraud would be less because the Appellant's export would not be related, via a direct chain, to the fraudulent non-payment of VAT.

46. The reasons why we are ignoring all the detail of the contra-trading in the case of Demravale are to some extent that:

- there clearly was available evidence of all the fraudulent non-payments of VAT by those companies that had imported the goods that Demravale in fact exported;
- Demravale's own figures in its relevant three-month period were in the staggering amounts of roughly £150 million for the deals of each category;
- Demravale's net worth was relatively trivial;
- the officers of Demravale have now been imprisoned for considerable periods for frauds on the exchequer; and
- the officers of Coast, Demravale's freight forwarder, and naturally the freight forwarder that would inevitably act for the purchasers from Demravale (i.e. for present purposes the Appellant), have also been convicted of criminal offences and imprisoned.

47. More significantly, however, the main reason why we ignore all the detail in relation to Demravale's transactions is that Declan Mundy very understandably conceded that it was now clear not only that Demravale's transaction had plainly been fraudulent, but he also accepted that many of the Appellant's earlier deals had been similarly connected to VAT frauds. All of the deals in February and March of 2006 as well as the later deals documented, but allegedly cancelled, in May and June involved purchases from Demravale. Declan Mundy's claim was that he had no idea how the mastermind behind the frauds had managed to manipulate the situation, such that the Appellant purchased from Demravale and then sold to the foreign customers that were obviously the essential purchasers for the mastermind's strategy to be accomplished, but he and the Appellant had nevertheless had no knowledge or means of knowledge of the connection of the Appellant's deals to these frauds. Declan Mundy asserted that, as was always the Appellant's pattern of trade, either he or Mr. Hughes would have sought orders from their various customers for the phones that were apparently on offer from Demravale or, had the facts been the other way round, and had they first received the orders from Pro-choice and Rachaeltel, they would have phoned around amongst their suppliers until they managed to find a supplier able to match the orders at a competitive price. We will revert to the very significant evidence of who had actually made or received the contacts in relation to these deals, but Declan Mundy said that he could not recall whether it was the availability of supply or the demand for goods from the customers that had come first in the case of the challenged deals.

Topics, emerging from the evidence of Mr. Humphries and the FCIB evidence, that are of central relevance to our eventual decision in relation to the Respondents' primary claim of "actual knowledge" and other features of the deals relevant to both actual knowledge and means of knowledge

48. While we are going to pay no further regard to the fraud at the level of Demravale, we will now deal with three further sets of topics. The first two, dealt with in paragraphs 49 to 51 and 52 to 54 respectively, are the evidence from Mr. Humphries and the FCIB evidence that would very likely not have been remotely known to the Appellant at the time, but that nevertheless lead to the supposition that the deals could not have proceeded as they did, had the Appellant not known that it had to acquire from Demravale and supply to Pro-choice and Rachaeltel. The third collection of topics, dealt with in paragraphs 55 to 85, deal with a number of features of the challenged deals that constitute material pointers to the conclusion that the Appellant must have had actual knowledge of the connection of its deals to

fraudulent VAT losses, or that it ought to have so known or, in many cases, to both of those issues.

Mr. Humphries' evidence

49. The first relevant topic is the topic on which Mr. Humphries gave evidence, namely the feature, according to his claim, that there was strong evidence that one mastermind was behind all the deals undertaken by companies in relatively short lists of foreign suppliers, UK contra-traders, UK exporters or brokers, and foreign (i.e. in these cases non-UK European) customers. According to his evidence there were five contra-traders (namely companies referred to as Computer Component Marketing, Demravale, Gerrimax, Prime Commodities and Signal Telecom) and they generally acquired from one of the foreign suppliers, there being three on the list, referred to as Atlantic IT Factory, an Irish company, and companies referred to as Stankom and Slavikom. In the present case, Demravale acquired most of the phones from Atlantic IT Factory, and the Nokia 6680s from Stankom. According to Mr. Humphries, the contra-traders then had a choice of five candidate exporters, named as Eurocellular, Honeytel, Matrix Europe, RS International and Totel Distribution. Those exporters then had a list of 10 foreign customers to whom they regularly sold, namely Beni Communications, Cadi Master, Hierro Holdings, Kiara, Log Out Trading, Mountainrix, Pro-choice Comercio, Racheltel, Silverpound and Worldcall Sistemas.

50. Mr. Humphries' claim was that the form of transactions between these various identified companies was generally very much the same. The inference that he therefore asked us to draw was that the mastermind behind the transactions could ring the changes, splitting deals so that no single exporter was dealing with anything like the full list of sales effected by any one contra-trader, and also splitting deals at the next level so that exporters might not just buy one quantity of phones from a contra-trader and inevitably sell it in the same quantity to one foreign customer, but divide the sales amongst several customers.

51. Mr. Humphries also illustrated how the foreign customers of the UK brokers that exported phones acquired from Demravale, were also the customers for product directly exported by Demravale in those equal and opposite deals in which Demravale acquired from defaulters and exported, occasioning the input recovery claims that were to be offset against Demravale's output liability in the deals in which it sold domestically to the UK brokers.

The FCIB evidence

52. The Appellant was not represented by counsel and so no opportunity was taken by Declan Mundy or the Appellant to cross-examine Mr. Humphries or to suggest that the points about similarity of deals and ringing the changes as regards current "performers" were perhaps questionable. Our decision is that Mr. Humphries' analysis does nevertheless appear to be realistic. This observation is fortified by the second topic that we must refer to, namely the FCIB evidence that certainly shows that the payments in the present case were circular; all payments flowed through FCIB accounts and the payments that were traced extended not just to the phones sold by Demravale to the Appellant and exported by the Appellant, but to the "equal and opposite" goods being acquired by Demravale from the UK chain and the defaulter, and then exported by Demravale. Several of the companies making payments (though not the Appellant itself) used the same IP address when logging on to make their payments. Everything, in other words, was very plainly pre-arranged and it was clear that the money could not have completed its required circle had there been any chance

that any of the parties might have purchased from an entity or sold to an entity, contrary to the planning expectations of the mastermind.

53. The FCIB evidence also demonstrated that some of the companies in the hidden foreign parts of the chains appeared in transactions involving other companies on the lists (whether importers, contra-traders, exporters or foreign customers), and not just the companies with which we are immediately concerned. Furthermore, the Appellant's March deals (again effected within the last two or three days of the month) were with Demravale on the one side, and Pro-choice on the other, but on this occasion the second foreign purchaser was Kiara, another of the available purchasers on Mr. Humphries' list.

54. Our conclusion, as a finding of fact and not simply because this point was readily conceded by Declan Mundy, is that Mr. Humphries' evidence seemed entirely credible; it was clearly supported by the FCIB evidence, and we conclude that his claim of the ability to ring the changes between the parties on the list was correct. The only aspect of this conclusion that is actually relevant and vital to our eventual decision, is that the evidence demonstrates that the deal chain, meaning the feature that Demravale had to sell to the Appellant, and the Appellant had to sell to Pro-choice and Rachaeltel, had to have been be pre-arranged, and the planning must have precluded the possibility that any of those parties could have purchased or supplied in some manner other than as in fact they did. The more remote points concerning the ability to switch one party for another, and everything else to do with Mr. Humphries' lists are not vital to the critical point of required pre-arrangement. Declan Mundy periodically referred towards the end of the hearing to the fact that the Appellant had clearly been manipulated to do precisely as it had done, and that he could simply not work out how anybody had been able to achieve this result. He did not seek to advance the unarguable, namely the contention that the steps, including those either side of the Appellant, had been otherwise than pre-planned.

Other material facts, relevant both to the Respondents' contention as regards actual knowledge, and the secondary contention that the Appellant ought to have known of the connection - Initial observations on the facts

55. We will now list various facts, many of which are relevant to both of the Respondents' contentions, i.e. concerning actual knowledge, and secondly that the Appellant ought to have known of the connection of its deals to VAT frauds. We will usually follow each indication of facts with some observations. These observations are certainly not findings of fact, but conclusions that we draw in relation to the particular facts. None of them purports to be a sufficient reason for a decision in the Appeal of any sort, but rather to be relevant factors in informing our eventual decisions on both critical points.

Two-pin plugs

56. We consider it highly relevant that the phones traded in the present deal had two-pin plugs, though the same point would obviously apply with phones being exported from the UK to continental Europe, whether the plugs were two-pin or UK-style three-pin plugs. In the case of two-pin plugs, at least the exporter is not embarrassed to be selling plugs to the continent where they would be unsuitable because two-pin plugs are extremely common on the continent. The exporter's obvious question when acquiring two-pin plugs from a UK supplier, noting in particular that no mobile phones are actually manufactured in the UK, is

that it makes no commercial sense for phones with chargers with two-pin plugs to have come to the UK in the first place.

57. Equally in the reverse direction, if the phones being exported had had three-pin plugs it would be yet more obvious that it would be strange for such phones to be being sold to continental European customers, albeit understandable that they may have been available in the UK market.

58. We will deal in much more detail below with many other points in relation to Mr. Hughes' evidence but, in the present context, Mr. Hughes first suggested that he thought that the phones exported in this case had had three-pin plugs, when they had in fact had two-pin plugs, and he also said that the Appellant's deals involved both types of plug. We suspect that the vast majority had two-pin plugs because that choice for the fraudster was at least the less embarrassing of the two. Finally, and on several occasions, Mr. Hughes drew parallels with the importation of tobacco in the 16th century, and the East India Company's importation of tea, suggesting that the UK was then, and now remains, a trading nation, and that product often came to the UK so that it could be re-exported. Our observation on that particular point is that its relevance to bringing two-pin plug chargers and the related mobile phones into the UK is just ridiculous.

59. We consider it absolutely extraordinary that people dealing honestly with phone trading for years never gave thought to the "give-away" feature that unsuitable phones were regularly available for purchase in the UK, involving double cross-Channel transit on their sale back to the continent, assuming that the phones existed, all for no remotely obvious commercial reason.

Product description

60. The Respondents' counsel placed considerable emphasis on the point that both generally and on the specific facts of the challenged deal, the description of the mobile phones in orders and invoices had almost always been inadequate. There were also often inconsistencies between the descriptions in purchase orders and invoices for the same transaction, and between the descriptions of product purchased by the Appellant and then supplied by it. It was suggested that the evidence in relation to *bona fide* trading given by Mr. Fletcher, the ex KPMG specialist in relation to grey market trading in mobile phones, had made it clear that in the genuine market, phones would never be offered or sought without the relevant party giving a full description of the phones, including model number, frequencies, suitability for particular markets, colour, type of chargers and plugs, instructions manuals and included languages, terms of guarantees and possibly other factors. It was suggested that in the genuine market, parties would never enter into deals with only a description such as "Nokia N70".

61. In the present case, the Respondents' counsel asserted that the description "Central European languages" was insufficiently detailed to indicate the required languages, and beyond that there were very few indications of specification. For instance the list of items on Coast's inspection check list, all being ticked "Yes", included a number of items of specification that were not mentioned on any invoice that we were shown in relation to any of various transactions.

62. We place little reliance on the following point because it was not established by the evidence given in this case, but other MTIC reported cases have offered examples of grey market trading in which not only Mr. Fletcher's point about accurate product description is clearly seen as an essential feature, but in auctioning excess and unwanted stock, companies such as Tesco and Asda will require traders to examine the stock before bidding in auction, after which if they bid they can make no claims about suitable product description or condition etc. In addition, and very significantly, it is made clear that the successful bidder must pay the full price to the seller before removing the phones from the seller's warehouse. It seems indeed that while Declan Mundy referred to the manner in which stock was always allocated and released without payment *"in the industry"*, and suppliers were only paid after customers themselves had paid, this was another feature of all MTIC deals and the deals with which we are concerned, that was extraordinarily unlikely to be reflected in *bona fide* grey market trading.

63. We accept that for various reasons, the inadequate product descriptions in all the Appellant's deals was more consistent with the indifference of fraudsters to the exact specification of the phones (or indeed, it seems in this case, quite possibly to whether the phones actually existed at all), rather than to the critical attention that would be given in the genuine market to every aspect of product specification.

Terms of trade

64. Approximately £5.7 million worth of phones were purchased and on-sold in the Appellant's transactions with which we are concerned, and we find it extraordinary, and entirely inconsistent with any pattern of *bona fide* commercial trading, that there were so few terms of trade of any sort.

65. The first relevant point in relation to trading terms is that both Mr. Hughes and Declan Mundy repeatedly asserted that when there had been an exchange of purchase orders and invoices, there was not a contract, or at least if there was a contract, it was one from which the parties could back out if, for instance, later Redhill requests were met with adverse responses, or even if one of the parties just wished to abort the deal. Assuming, as we do, that there was a legally-binding contract to pay and supply once purchase orders and invoices had been exchanged, there were certainly no stated conditions in the contract permitting a party to withdraw in some given eventuality, or indeed in any event.

66. Most of the purchase orders and invoices referred to two terms, if to any. One was the usual term imposed in relation to payment by the supplier to the Appellant which generally said something to the effect of "Payment on Inspection". In this case, it was the Appellant's purchase order to Demravale that indicated that payment would be made following inspection and the receipt of an invoice.

67. As regards transfer of title, the supplier to the Appellant's direct supplier and that direct supplier would generally insert a title retention clause along the lines of "Goods to remain the property of [the supplier] until payment in full has been received". In this case, Demravale's invoice clearly provided for title retention until Demravale had been paid in full, as we quoted in paragraph 37 above. The Appellant would then provide for either a transfer of title, or slightly more obscurely for "a full release" (i.e. a release from the Ship on Hold terms on which the goods would normally have been shipped abroad) to its foreign customer, upon Inspection and Payment by the customer.

68. The very serious problem with the fairly standard term for the payment of price, in this case for the supply to the Appellant from Demravale (the term almost invariably used by suppliers to exporters), was that it was simply not true. It was the very essence of the dealing, or as Mr. Hughes and Declan Mundy would express it, "the tradition in the industry" that the exporter would not pay the price on inspection. It would, and inherently could, only pay the price once, in its turn, it had received the full price from its customer. It was of course too embarrassing for the price payment obligation to be worded in that fashion, and so the plainly wrong "Full payment on inspection" was specified in the Appellant's purchase order to Demravale in this case. One of the knock-on consequences of the fact that the term about payment of price was just clearly wrong, was that the supplier's term gave no guidance as to whether the purchaser's (i.e. the Appellant's) purchase obligation was a limited recourse obligation (under which it would only be liable to pay, were it eventually to receive payment from its customer), or whether after some period of grace (or credit) the purchaser would eventually have to pay the price. There is no point in speculating as to which analysis might have been correct, as the reality is that (as we now see and the Appellant concedes) the deal was planned, and no default was anticipated. But when the Appellant asserts that it believed that the deal was a *bona fide* commercial deal, the Appellant ought to have noted that the payment term was wrong, and did not accord with its own quite plain expectation that it would not pay until it itself had been paid and, since it was untrue, it left it unclear what the liability to the supplier would be if the customer failed to pay.

69. The same point applies of course to "Title transfer". Although the Appellant would be purporting to give a full release to its customer once the customer had paid for the goods, the Appellant might have noticed that this would again not make sense because, until the Appellant had paid its supplier and, in many cases, until various earlier parties had all been paid, title would not pass down the line of suppliers (or worse still from the party that owned the goods at the start of the chain, straight to the foreign customer) until all the payments had been made.

70. The glaring pointers to "non-commercial" and "non-genuine" trading in the present context were that there were virtually no trade terms whatever for deals involving £5.5 million worth of product, and insofar as there were two terms, they were both wrong, and very materially and deceptively wrong.

Insurance

71. As we recorded in paragraph 28 above, the Appellant claimed that its goods were always insured, and the claim was even pursued in relation to the challenged deals in this case. In the event it transpired that even if the Appellant thought that it had asked the freight forwarder to arrange for insurance, there had been no insurance for at least three reasons. Firstly, Coast did have some insurance cover, but it expressly excluded the transportation of mobile phones. Secondly, although Declan Mundy claimed that the reference to an "admin" charge on Coast's invoices must refer to insurance, it became perfectly obvious that the very modest charge for admin could not refer to insurance. Declan Mundy indicated the expected charge for insurance and the admin change was of a materially lesser amount. The third relevant factor in relation to the absence of any insurance cover is that Declan Mundy confirmed that he would never have actually looked at the invoices from Coast. Charges by freight forwarders were an inherent cost of the Appellant's trade and he could do nothing about such charges, so Declan Mundy said that he

would simply have passed the invoices to his father for payment and recording purposes. He would not have looked at them.

72. In short, in relation to insurance, the conclusions are that the goods were not insured and that Declan Mundy's attention to ensuring that his claim that everything was insured was so lax or non-existent that it seems that the issue of insurance was not taken seriously. Had Declan Mundy looked at either the Coast invoices or, perhaps more appropriately, considered the terms of insurance, he would instantly have ascertained that the goods were not insured and that the Appellant was not paying for insurance.

The credit reports on trading partners and the attention given to them by the Appellant

73. As encouraged to do by HMRC, the Appellant obtained credit reports from Dun & Bradstreet on most of its suppliers and customers. Invariably those reports revealed that neither the suppliers nor the customers were companies with any significant net worth, or companies on whose credit standing anybody could seriously rely for the sums of money involved in the trading conducted by the Appellant. Equally obviously and invariably, the Appellant's contention was that they were not particularly troubled about credit standing of their trading partners because they were neither receiving nor (more materially) giving credit. In the case of their supplies to foreign customers they generally supplied goods on a Ship on Hold basis such that the customer's freight forwarder should not release the goods to the foreign customer until the Appellant had authorised its freight forwarder to inform the foreign freight forwarder that the goods could be released. Accordingly, although the goods had been shipped abroad without the Appellant having received payment at that point, the goods would not be fully released to the customer until payment had been made. Were the customer to fail to pay, the goods could either have been sold to some other unidentified party or brought back to the UK at considerable cost to the Appellant and sold from there.

74. We reject the argument that the Appellant could legitimately disregard the credit standing of its trading partners. The Appellant was meant to be looking out for indications of fraudulent dealing. The feature that none of the parties, including Demravale, the Appellant, Pro-Choice and Rachaeltel, had any significant net worth or realistic credit standing obviously meant that:

- the Appellant should have observed that Demravale could not have actually purchased the goods that it was offering for sale, without some party having given inexplicable credit in circumstances where Demravale was effectively worthless; Demravale was proposing to sell to an Appellant that was effectively worthless, and that customer of Demravale was in practice only going to be able to pay Demravale if the Appellant's completely unknown customer (assuming that a pre-sale had been arranged) was going to pay the Appellant;
- in the alternative, Demravale would not have owned the goods, but would be acquiring them from some earlier supplier and paying that supplier only after the Appellant had paid Demravale, which in turn the Appellant would have known would only occur once it had received payment from its own worthless customer, which must presumably have received payment from some other, utterly unknown, further party in the chain;
- when the Appellant was only expecting its customers to be able to pay if, in its turn, it received payment from some later, equally completely unknown, purchaser it is extraordinary that notwithstanding the risk of this, the Appellant was always ready to

ship goods to its customers' foreign freight forwarder, when knowing nothing about the integrity of the customers or the freight forwarders. Had a customer failed to pay for the phones, the Appellant's more realistic concern would have been the issue of whether it would ever regain control over the phones, rather than the cost of (rather pointlessly) calling them back to the UK or seeking to find a replacement foreign purchaser, potentially for a lesser price.

75. These obvious features just summarised will have been commonplace in virtually all of the Appellant's deals, and not only in the case of the present challenged deals. We cannot accept that genuine traders, as distinct from those that knew that the deals were scripted and that everything would proceed smoothly, would ever have taken the risk of dealing in such large amounts with a list of companies, none of whose credit standing was remotely adequate.

76. Mr. Hughes told us two things in relation to credit checks and to the whole feature of considering what the Appellant's customer was going to do with the goods purchased from the Appellant. The first was that credit checks were principally conducted just to establish that the supplier or the customer existed. As to the issue of what the customer was going to do with goods purchased from the Appellant, Mr. Hughes could not find out what the customer was going to do with the goods and, to quote one of his answers, the customer could throw the goods in the sea.

77. When every deal flagged the issues that we have posed in paragraph 74 above, we consider that there were sufficient known facts to put Declan Mundy and Mr. Hughes on notice that they needed to give very careful attention to the immediate parties in the supply chain of worthless companies, the basic characteristics of which were always perfectly obvious to them.

78. In a quite different context, Mr. Hughes gave some rather extraordinary, and in the event irrelevant, evidence when he challenged the statement by the Respondents' counsel that the manufacturers of phones, such as Nokia, sold directly to their authorised distributors. Mr. Hughes' claim was that there was an intermediate step in that the manufacturers sold first to a syndicate of financial investors, and they in turn sold to the authorised distributors. We eventually concluded that the more likely scenario was that the manufacturers sold directly to the authorised distributors, but because the authorised distributers were doubtless liable to pay for the phones on delivery, they needed finance. Presumably the finance was provided in the form of syndicated loans, hence the reference to a group of investors. The only point that we actually drew from the discussion of financing the authorised distributors was that this whole consideration made Mr. Hughes' assertion that the Appellant applied to Nokia and sought to buy directly from Nokia seem far-fetched. When the Appellant was obviously unable to pay in advance, or on delivery, or even after a short period of credit, and when the Appellant had no distribution network, the prospect that Nokia would be prepared to sell directly to the Appellant seemed so improbable as to make the suggested request futile, and to throw considerable doubt on whether the request had indeed ever been made.

The dates on which Dun & Bradstreet reports were received, and Redhill checks received in relation to the April 28 deals

79. Quite apart from the feature just dealt with to the effect that little attention was going to be given to Dun & Bradstreet reports, it is worth noting that the totally uninformative report on Rachaeltel was not received until 4 May. This indicated, rather naturally with a newly

formed company, that no information was available about the company's credit standing. We know that both Mr. Hughes and Declan Mundy asserted that they could pull out of a deal after offers and invoices had been exchanged, and that they were going to pay no attention to the report anyway, but we still note that the Appellant invoiced Rachaeltel before learning anything about its credit standing, and certainly did not seek to pull out of the deal on receiving the relevant uninformative report.

80. More significantly, the VAT registration number checks on Pro-Choice and Rachaeltel were not received until 5 May. They were at least checks that confirmed that the numbers were valid registrations. By contrast the check on Demravale that came back on 3 May said:

> *"The information provided by you concerning [Demravale – 772 821810] differs from that held by Customs and at this time I am not able to confirm that this is a valid registration"*.

Notwithstanding this reply, nothing was done to abort the April deal, and in part that was explained by the claim, either that the Appellant assumed that there was simply something wrong with Demravale's address, or that as the response was the same as that received in respect of the March deal, it was obviously assumed that everything was in order. We are far from clear that there was any supposition that Demravale's principal place of business had been changed or that any other relevant address had been changed. Moreover, although the Appellant's March deal was cleared for payment by HMRC in mid-May, this was critically not known to the Appellant when the April deal was arranged, or when the Appellant had to pay attention to the terms of the Redhill response just quoted. Accordingly the April 28 deal was dealt with on 28 April without any of the Redhill checks being in place, in circumstances where critically there would turn out not to be a confirmed check for Demravale's VAT number, and when the Appellant had not yet received the credit report on Rachaeltel, a company that had barely traded, and whose business was apparently stated to be that of importing and exporting industrial equipment.

The delay in the receipt of payment

81. While the Appellant's invoices to both customers said that the Appellant required "*Same day payment"*, neither customer paid for the goods invoiced on 28 April until either 30 or 31 May 2006. While Declan Mundy said that he never took too seriously the insistence that the goods be paid for immediately, they had been inspected and found to conform to the required description, and while the Respondents' counsel pointed out that the Appellant would in fact have no idea anyway when the goods had arrived at their destination and been inspected, it was still odd that payment was not made for such a long period. Declan Mundy said that the delay in receiving payment occasioned many phone calls, but there was no documentation to prove this and we were not told what the two customers said.

82. It naturally follows that if the Appellant had reason to believe that everything was pre-planned, and that whatever its own purchase orders had said about the Appellant's obligation to pay Demravale, in reality the Appellant would only have to pay Demravale if and when it received payment from the customers, the delays in payment would simply assist the Appellant's cash flow by deferring the date when its own greater payments, that would exceed the receipts from Pro-Choice and Rachaeltel, would have to be paid. Were the

Appellant to be aware of pre-arrangement in other words, the Appellant might not be too troubled about materially late payments.

83. By contrast, were the Appellant to be oblivious to pre-arrangement, it might consider that even though there may have been one late payment from Pro-Choice with which the Appellant had traded on several occasions, so that that might not undermine the Appellant's confidence in Pro-Choice, the 28 April deal was the first deal undertaken with Rachaeltel. It might indeed have occurred to the Appellant that it was somewhat odd that both apparently completely unrelated purchasers were both paying late on virtually the same date. Quite apart from that, if the Appellant had been disturbed by the late payment by Rachaeltel on the first occasion that it had traded with Rachaeltel, and in a relatively significant amount as well, it seems odd that on the day when, or even before, the Appellant received payment from Rachaeltel, the Appellant had undertaken a further deal with Rachaeltel, as part of the late May deals. This seems to indicate either complete knowledge of pre-arrangement, or a very surprising response to unsatisfactory conduct by a new trader on the first deal undertaken with that trader.

The May and June deals

84. At the very end of May, a further large deal was done involving all the same parties, namely Demravale, Coast, the Appellant and Pro-choice and Rachaeltel. We are not going to assert that we actually know what happened in relation to this deal, or indeed to the yet later one done at the end of June, but the Appellant asserted that both were cancelled when the Appellant realised that the April deal was to be subjected to extended verification. Since the Appellant would not have appreciated that fact in relation to the April deal until July, we are far from clear whether the goods in the May deal had all been despatched, and whether therefore the claim that the deal had been reversed suggested either that very late delivery of the goods had never occurred or that the goods had been shipped, and were perhaps shipped back. Or, the final possibility was presumably that they had been shipped and not shipped back at all. Some payments had apparently been paid by the customers and the Appellant's onward payments had been made to Demravale, but when the Appellant (principally it seems through the efforts of Mr. Hughes) sought to recover the payments from Demravale, it failed to do so. The efforts were eventually abandoned on the reasoning that the Appellant had not suffered because, while it had not managed to retrieve payments from Demravale, it had not had to refund deposits or payments to the customers either. So it was matched. This all makes sense of course if the deals were simply matched pre-arranged deals, but it can have made no sense to the Appellant if the Appellant thought at the time that all the parties were genuine traders. For then either the customers would have retained the goods, and it seems not paid the entire price, or if the goods had never been supplied or they were returned, then plainly the customers would have wanted their payments returned.

85. We will now ignore the May and June deals because, while their reversal indicated that the deals were extremely odd, we now know, and the Appellant has confirmed that it is accepted, that all the deals were indeed circular and pre-arranged. Since inferences drawn from the May and June deals post-date the critical time at which we must decide whether the Appellant did or should have known of the connection of its April deals to fraudulent VAT losses, there seems to be no further point in stressing the extremely odd circumstances of the cancelled deals, virtually all the details of which Declan Mundy claimed, somewhat unconvincingly, to have forgotten.

The Appellant's contentions and the particular elements of the evidence given by Declan Mundy and Mr. Hughes that we need to record

The Appellant's contentions

86. The Appellant contended that it did not know at the time, albeit that it now accepted, that the challenged deals, and indeed many others, must have been connected to fraudulent VAT losses. Declan Mundy said that he simply could not work out how some mastermind must have manipulated the Appellant to adopt the role that it had undertaken. He also stressed that the Appellant had always got the impression from its good dealings with its previous officer, Mr. Rowe, that the Appellant was performing the checks that HMRC instructed traders to perform, and that, particularly because all claims for repayments had been met, it was assumed that its deals had been, as allegedly supposed, *bona fide* grey market deals.

87. The Appellant also criticised various aspects of HMRC's conduct. It was stressed that when the Appellant, with its limited powers of enquiry, had checked the credentials of its immediate trading partners, and had of course been unable to ascertain anything about more remote parties, it was noteworthy that HMRC themselves had not de-registered Demravale until well after the date of the April deals, i.e. until July 2006. Furthermore it took HMRC until August 2007 to complete its extended verification of the Appellant's April deals and if it took that long to reach the conclusion that the deals had been connected to VAT losses, how could the Appellant, with its necessarily more limited opportunities to obtain information, have known in April that the deals were indeed connected to VAT frauds?

88. There was also considerable criticism of HMRC for now revealing that they had been suspicious of the activity of Demravale earlier in 2006 than April, and for not having warned or tipped off the Appellant at the time of the March and April deals, counselling it not to deal with Demravale.

Particular features of, and observations on, Declan Mundy's evidence

89. Much of Declan Mundy's evidence was coloured by claims that the Appellant had believed that the Appellant was acting in conformity with HMRC's directions, and that had Mr. Rowe been available to give evidence, his evidence would have been to the effect that the relationship with the Appellant had always been good. In giving our decision we will revert to this point, and to the critical issue of whether Declan Mundy and Mr. Hughes genuinely believed that they were attending to all the required due diligence, and thereby avoiding involvement with MTIC fraud, or relying on the fairly prevalent view in early 2006 that traders had a good defence to joint and several liability claims and forfeiture of the right to deduct input tax if they could show that their immediate trading partners were not the VAT defaulter. In that context, we should perhaps make the immediate point that in all the deals involving Demravale, the Appellant was not dealing with one of the buffer companies at the end of a string of supposedly innocent buffers, but was actually dealing with the contra-trader.

90. Beyond those claims, there were no, or virtually no, elements of Declan Mundy's evidence that we considered to be clearly untruthful. We accept the Respondents' counsel's contention that there were numerous occasions on which Declan Mundy claimed to have forgotten detail. It was regularly asserted that after 8 years, it was impossible to

remember any of the detail of the challenged deals, or the detail of the way in which the May and June 2006 abortive deals with the same parties were allegedly abandoned or reversed. We agree with the Respondents' counsel that while 8 years have indeed elapsed, only one year had elapsed by the time the Appellant knew that its April deal had resulted in a rejection of the repayment claim, and that at that stage, surely the clear detail of just one actual transaction, and the unique steps in unravelling very major deals for May and June must have been clear in Declan Mundy's and Mr. Hughes' minds. Had they thought that they might forget the details (or rather the very fundamental points), they could have recorded their intended evidence on paper. We agree with the Respondents' counsel's claim that we did not believe every claim by Declan Mundy that he had forgotten matters.

91. We must mention two other related elements of evidence given by Declan Mundy.

92. At the end of the one full day on which Mr. Hughes was present in court, Mr. Hughes was cross-examined for the entire day, but we did not reach the critical subject matter of whether it was Mr. Hughes or Declan Mundy who had located the parties to the challenged deals. Since indeed, Mr. Hughes had had virtually no role other than that of identifying deal counter-parties, and he had certainly attended himself to none of the due diligence or the transaction documentation, we had barely reached, by the end of the relevant day, the only topic on which we really needed to hear Mr. Hughes' evidence.

93. When, on the following morning, Mr. Hughes had returned to Sunderland, we were endeavouring to ascertain whether his absence was going to be critical or not, so that we asked who it was out of Mr. Hughes and Declan Mundy who had actually identified the parties for the April deal. Declan Mundy's response was *"This was more of a Russell deal than myself"*. This reply obviously made Mr. Hughes' non-appearance rather more regrettable, in that it followed that we would hear no evidence from Mr. Hughes on the only subject in relation to which we were particularly interested in his evidence. It emerged, however, that there was no realistic prospect of adjourning the case for a day or two (even though in the time-scale set down for the Appeal this would have been a possibility) since we were told that Mr. Hughes would not be available for a much longer period.

94. On the same subject, when we came to deal with the challenged deal with Declan Mundy, the following exchange between Declan Mundy and the Respondents' counsel is worth quoting:

> *"Q. Were Rachaeltel well established?*
>
> *A. I wasn't familiar with Rachaeltel, no.*
>
> *Q. No. You'd not traded with them before, had you?*
>
> *A. At this stage, no.*
>
> *Q. Can you help us with how Rachaeltel became a customer of yours in these deals?*
>
> *A. I can't specifically give you times or details of how they contacted us, or we contacted them.*
>
> *Q. Was it you or Mr. Hughes, can you help us?*

A. I think it was Mr. Hughes, it may well have been me, but again we are talking eight years ago, I can't give you details about how I contacted somebody, when I contacted somebody.

Q. These are the very deals that we're …

A. I know Mr. Foulkes, they are and there are only two deals I need to get my head around in this case.

Q. But you don't remember?

A. I don't remember eight years ago exactly –

Q. Did you remember in 2007, when you started this appeal, think to maybe record for your own benefit how this all happened, so that you could explain yourself to the tribunal and how it's all been some dreadful mistake?

A. At the time, I didn't think that that would be necessary, this is all new to me, this, so if I had known that then I would have done it.

Q. You didn't think, when you were drafting your witness statement. Was this witness statement drafted by a lawyer on your behalf, obviously taking instructions from you, or was it your own words?

A. By myself, it's mainly my own – by myself, and with aid from Iain Manley from Vantis, I think.

Q. Your representative at the time?

A. Yes.

Q. All right. You didn't at any stage think that it would be sensible to note down how the deal was undertaken? You've got a lot of detail in here in some areas, Mr. Mundy.

A. Well, I took guidance from my brief at the time.

Q. And now you can't help us. You must have gone through in your mind many, many times, "What could we have done differently, and what is it that the problem is here"?

A. The position is, as I recall, that Russell contacted me with a matched deal that he wanted me to generate the documents for.

Q. You just don't know who did the deal?"

95. Without anticipating our decision at this point, there are three important points that emerge from the above quotation. Firstly, it exhibits the improbable feature of Declan Mundy claiming to have forgotten critical detail. Secondly it exhibits virtually no

knowledge of the purchaser, Rachaeltel, which is fairly extraordinary when we note that it was a new customer, Declan Mundy did not know how it had been located, and the Dun & Bradstreet check on it, which in the event was totally uninformative, was not obtained (as also the VAT registration number check) until several days after 28 April. Much more significantly we note the two features that Declan Mundy thought that the 28 April deal was "a Russell deal", and more significantly still, that "*Russell contacted me with* ***a matched deal".***

96. We are satisfied that the initial contacts for the April deal were made by Mr. Hughes and not Declan Mundy. This is in part because evidence of later contacts with the same parties, and information from Coast, all in relation to the effort to abort the May and June deals, involved communications from and to Mr. Hughes and not Declan Mundy.

Particular features of, and observations on, Mr. Hughes'evidence

97. We found much of Mr. Hughes' evidence during cross-examination to be very unsatisfactory. Notwithstanding that on the day in question the Respondents' counsel only raised questions in relation to relatively non-central issues, virtually every topic ended in Mr. Hughes' responses either being improbable, or in attacks on the Respondents' counsel or in it emerging that the evidence changed.

Mr. Hughes' role

98. When dealing with the early contacts between Mr. Hughes and Evolink, when Declan Mundy was working at Evolink, we gained the impression from Declan Mundy that Mr. Hughes role was essentially that of a commission earning broker, who simply introduced deals to Evolink but was not actually a seller to or buyer from Evolink. Mr. Hughes'evidence was that his company's role was to sell to Evolink or to buy from it. Since Mr. Hughes' role in relation to the Appellant was always intended to be just that of locating deals, we tentatively assume that Declan Mundy's description of the relationship that Mr. Hughes had with Evolink was the more likely explanation but we cannot be certain of this.

General source or origin of the stock traded in the Appellant's deals

99. In relation to questions from the Respondents' counsel as to Mr. Hughes' supposition as to the source of phones traded by the Appellant, Mr. Hughes explained that their product resulted generally from excess purchases by UK white market authorised distributors that wished to dispose of such excess stock. This explanation struck us as improbable because the immediate supplier to the Appellant had never been such a distributor. If this was accounted for by the fact that the Appellant could not afford to pay up-front for phones sold by an official distributor, it seemed equally odd that some intermediate would be interposed, presumably increasing the price of the phones to the Appellant, but then being ready to defer its receipt of sales proceeds until the Appellant had itself been paid, all in circumstances where the relevant seller had little knowledge of the Appellant and no knowledge of whether the Appellant had on-sold the phones, and if so, to which customer.

100. It also seemed extremely improbable that excess stock being sold by UK authorised distributors would be of stock with chargers with two-pin plugs that would not have been suitable for sale in the UK anyway.

101. As we have mentioned, Mr. Hughes claimed that the Appellant approached Nokia with a request that Nokia sell directly to the Appellant. This seems to have been such an extraordinary suggestion that we do not believe it.

Knowledge of MTIC risks

102. Mr. Hughes was reluctant to indicate when he first learnt of problems in relation to MTIC trading, and confirmed that it was probably *"around 2002/2003, … but I can't remember exactly when"*. Mr. Hughes then contended that there was fraud in virtually any industry and trade, and only reluctantly conceded that the nature of VAT fraud in relation to exportations of mobile phones and CPUs was somewhat more widespread and, according to HMRC, always related to VAT frauds.

Dun & Bradstreet checks

103. When asked why the Appellant conducted Dun & Bradstreet checks on trading partners, the answer was:

> *A. Well, to check if – to check if the company was actually there.*
>
> *Q. Right.*
>
> *A. It wasn't that important that – as long as the company was not pretending to be something it wasn't. So we would – we would do them checks when possible. I mean, I never used to physically do them. Normally it was Declan or the office manager."*

De-registration notifications

104. When questioned about his reaction to indications from HMRC, both in the trading period in 2002 and up to April 2003, and equally in the trading that re-commenced in and after August 2003, that HMRC had de-registered numerous traders for which the Appellant had sought "Dorset House" or "Redhill" checks of VAT registrations, Mr. Hughes said that he was not very concerned about this. He criticised HMRC for generally getting their information wrong, and suggested that it was usually the case that negative responses from HMRC to such checks resulted from some confusion on the part of HMRC about a change of address and, very shortly afterwards, it would emerge that the relevant company had either been re-registered or had perhaps not been de-registered in the first place. He ended up contending that this was the position with "nine out of ten de-registration" notices, or "nine or ten out of ten de-registrations notifications". In his later evidence, Declan Mundy reversed the figures and said that perhaps the information was later changed in the case of one out of ten checks.

Timing of checks

105. When asked why deals were often done prior to receipt of the responses from HMRC in relation to Redhill checks, Mr. Hughes explained that if a check came back with a negative response, any deal could always be aborted or reversed. Beyond the fact that this response was wrong if we were right to suggest that there would have been a contract for supply once purchase orders and invoices had been exchanged, and the contract made no reference to

conditions about IMEI numbers and Redhill verifications etc, it would manifestly have been difficult and costly to have retrieved stock from the continent in order to reverse such a deal if the Appellant had wished to do so. In reality this of course never happened.

Two-pin plugs

106. When asked how it was that Mr. Hughes supposed that phones with two-pin plugs were available for purchase, and regularly available for purchase, in the UK market, when they would principally be suitable for use on the continent, Mr. Hughes appeared to claim that there was nothing strange in this. Adaptors could readily be used. We assume that in 2006 the practice of supplying plugs with inter-changeable pins was either rare or non-existent. Mr. Hughes ended up suggesting that the phones whose chargers had two-pin plugs would have come to the UK because the UK was a trading nation, and just as tobacco and tea had been imported on wooden ships and re-exported, so too the UK was still acting as a trading nation in that same tradition. We obviously regarded that claim as ridiculous.

107. Two further points are noteworthy in relation to the two-pin plug issue. First it was inconsistent with the supposition referred to above that the original source of stock for the deals undertaken by the Appellant would have been that of UK authorised distributors unloading excess stock that they had ordered from manufacturers. We cannot conceive that UK authorised distributors would regularly have ordered stock for delivery in the UK that would almost invariably have had to be shipped to the continent for retail sale. Secondly, the Respondents' counsel suggested that if stock with two-pin plugs had been imported into the UK to meet a genuine, albeit rather curious, demand, it seemed odd that that special demand always seemed to evaporate so that the genuine UK trader that had bought such stock to the UK had had to unload it into the grey market.

108. We concluded that in endeavouring to brush away the improbable feature of the Appellant regularly being able to purchase stock with two-pin plugs in the UK, Mr. Hughes failed to convince us of any legitimate explanation for this "give-away" feature.

Product description

109. Both Mr. Hughes and Declan Mundy admitted that they had no idea what the product description of "No labels" that they put on their purchase orders to Demravale in the challenged deals meant. Yet they appeared to have initiated this feature of required specification.

Due diligence

110. In response to questions from the Respondents' counsel as to whether the Appellant had ever sought to ascertain from suppliers and customers whether they in turn had verified their trading partners, Mr. Hughes indicated that this would be a preposterous request, indicating suspicion and bad faith, that they could not possibly put to trading partners. Since it was well known that HMRC were suggesting that such questions be posed, and that in countless back-to-back deals due diligence questionnaires had posed precisely these questions, we reject the notion that suppliers and customers would realistically have been affronted by the Appellant pursuing the enquiries that HMRC had indicated that all traders should pursue.

Fraught exchanges with the Respondents' counsel

111. There were some very fraught exchanges between Mr. Hughes and the Respondents' counsel in which Mr. Hughes was repeatedly attacking counsel on the basis that he was not a businessman. The challenges generally focused on some course of conduct by the Appellant that was either indicative that the parties must have appreciated that the deals were pre-arranged and that they would proceed like clockwork or that Mr. Hughes was ignoring legal realities that we would expect any commercially-minded business to take seriously.

Conclusion

112. In conclusion, we were unimpressed with Mr. Hughes' evidence. It regularly involved fraught exchanges with the Respondents' counsel, and we should record that in our view the questioning by the Respondents' counsel was always perfectly legitimate, and indeed not remotely abrasive. We were very far from convinced that we believed everything that Mr. Hughes said. We would have been very interested to hear his responses to the first highly relevant questions that were doubtless to be put to him on the second day of his cross-examination. We do not for a moment question that he was in evident physical discomfort in the witness stand on the day when he attended the court, and we do not doubt that he suffered several health issues. Insofar as the medical report from his doctor indicated that his relevant ailments were knee and hip pain and that the feature that rendered his giving evidence to be impossible was that the painkillers that he was taking made him drowsy, we must record that he was anything but drowsy on the day on which he did give evidence.

The Respondents' contentions

113. The Respondents' principal contentions were naturally suggestions as to how we should analyses the evidence, and support the Respondents' two separate claims, firstly that the Appellant must have known of the connection of its deals to fraudulent VAT losses, and secondly that it ought to have so known.

114. We should however record the Respondents' particular reactions to the various claims by the Appellant that they had either been misled by Mr. Rowe or by HMRC responses to various enquiries into thinking that the Appellant's conduct and its attention to due diligence were all satisfactory, Furthermore there were the complaints that HMRC had given the Appellant no warning as to their suspicions in relation to Demravale, notwithstanding that such suspicion clearly existed from the very beginning of 2006, and the related claims that the Appellant could not possibly have known of the connection of its deals to fraud if it took HMRC so long to undertake the extensive verification exercise.

115. In relation to these various claims by the Appellant, the Respondents gave the following responses.

116. Firstly, in terms of taxpayer confidentiality it was improper for HMRC to divulge mere suspicions about a particular trader to other traders. When HMRC had grounds for de-registering a trader then notices were sent to all traders that had had any contact with the de-registered trader but it was improper and impossible for HMRC to issue warnings to other traders when they were simply conducting enquiries.

117. The very strong point was also made that we should be cautious of accepting the Appellant's claims that they should be exonerated from knowledge or means of knowledge by virtue of having conducted various checks in relation to their immediate trading counterparties because, in early 2006, and indeed from early 2005 to a lesser extent, countless traders would have been aware that the test for forfeiting the right to claim a deduction for input tax was going to be geared to knowledge and means of knowledge in relation to fraud. As a result, there was a common expectation amongst traders that, provided they undertook the required checks in relation to their immediate counter-parties, and obtained satisfactory VAT registration checks in relation to those parties, traders would be able to defend claims by HMRC to deny repayment of input tax by simply feigning lack of knowledge and means of knowledge. For this reason, the level of MTIC transactions had increased enormously in the early months of 2006, and notably the Appellant's turnover in that period had indeed increased very considerably.

118. The other point stressed by the Respondents was that although the Appellant claimed to have been convinced that HMRC, particularly in the individual relationship with Mr. Rowe, were satisfied with the Appellant's conduct, HMRC did always indicate that it was always for each trader to analyse its own trading risks and decisions. It was up to each trader properly to evaluate the information derived from due diligence. And even, for instance, when satisfactory responses were given to Redhill checks, the letters from HMRC always made it clear that the decision as to whether to trade was always the responsibility of the trader.

119. It was also contended by HMRC in this Appeal that the Appellant's due diligence had been far from satisfactory. Several checks that were said to have been made had not been made, as we will summarise in our decision.

120. The really decisive point, however, is that the question that we must answer is still whether HMRC has established, to the standard of the balance of probability, that the Appellant did know, or ought to have known, of the relevant connection of its deals to fraud. Insofar as we accept some or any of the Appellant's reliance on indications given by HMRC officers in relation to its conduct, this obviously makes the Respondents' burden somewhat more difficult, and certainly a hurdle that the Respondents must still surmount before we can dismiss this Appeal.

Our decision

The actual knowledge issue

121. Our decision is that the Appellant did know, in the sense that it simply must have known, that its deals were connected to VAT frauds.

122. Our reasoning for this decision is as follows.

123. Having accepted, as indeed the Appellant has now done, the evidence of Mr. Humphries and the FCIB evidence in relation to some central planning mastermind having lists of companies amongst which he could ring the changes and arrange for fraudulent deals and circular rotation of payments, it simply must be the case that the planning made it essential and inevitable in the case of the challenged deals that Demravale should supply to the Appellant and that the Appellant should supply to Pro-Choice and Rachaeltel. Had the

Appellant been able to acquire from or supply to some other party, the circular payment chain would have been broken and the planning objective not achieved.

124. Declan Mundy said that he had no idea how the Appellant had been manipulated in order to perform its clearly designated role between Demravale and Pro-Choice and Rachaeltel. There was thus no claim that there had, for instance, been some indication from Demravale that it had arranged to sell to Pro-Choice and Rachaeltel, but having run out of available finance to bridge "the VAT gap", it was ceding the opportunity to make the planned export sales to the Appellant. There was also no evidence asserting, for instance that, by a remarkable coincidence, the supplier happened to make the stock offer, and the customers happened to place the purchase orders simultaneously in the matching amounts such that everything fell into the Appellant's lap in some apparently magical way. The only evidence given was that in the allegedly typical manner, when one contact had been established (in other words either a stock offer had been received or a purchase order had been offered), the Appellant would ring around to its numerous contacts in an effort to match either the offer of stock or the request for stock in order to effect a back-to-back deal.

125. Proceeding from the conclusion that the pre-arrangement required the Appellant to effect the deals that in fact it did, and noting that the Appellant could offer no explanation to displace the otherwise likely conclusion that the Appellant must have known that it was performing a play-acting role in pre-planned transactions, we next note that in March, May and June the same pattern existed, save that in March, the supplies were made to Pro-Choice and Kiara, Kiara being another of the companies on Mr. Humphries' list. These further deals in accordance with the same pattern diminish the chance of some incredible coincidence explaining the role of the Appellant and make it yet more obvious that the only conceivable explanation for the actions of the Appellant must be that the Appellant knew precisely what it was doing.

126. It would be improper for us to pay much regard to the following factor, but when, according to Mr. Humphries' evidence, there were only five available brokers or exporters in the lists of available companies to the supposed mastermind behind these details, it is worth considering the fate of all these companies. The four, other than the Appellant, appeared to have been performing the same role. As regards these companies, we were told that not only had the directors of Demravale and Coast been imprisoned, but of the other four brokers available to export, the directors of one had also been imprisoned, a second broker had lost its Appeal before this Tribunal, a third had either abandoned its Appeal or the Appeal had been struck out, and no information was available about the fourth. We can at least reach the legitimate conclusion here that there was certainly no evidence that any of the other brokers had plainly, or even conceivably, been innocent dupes.

127. We next consider that while we do not purport to be able to explain how this result might have come about, we ought nevertheless to test the possibility that the Appellant had indeed been some form of innocent dupe, and we should assess whether this possibility is remotely credible.

128. In this context, the Respondents' counsel suggested that it was improbable that the mastermind would shed such a significant percentage of profit to the exporting broker if the exporting broker was indeed innocent. The profit expected to be made by the Appellant in relation to the 28 April deal was in the order of £300,000, that being an astonishing profit for participating in a deal that was commercially risk free (if the Appellant was right to suppose

that it only had to pay for stock if and when it had itself received payment) and that involved doing absolutely nothing, and certainly adding no value, other than issuing a few bits of paper to counter-parties, most of which were woefully inadequate. The relatively high level of profit was also something that flagged the oddity of the transaction to the intelligent trader, particularly when for no obvious reason the profit on the export deal was dramatically higher than the level of profit regularly commanded in back-to-back deals between two UK parties. So with an innocent dupe, there is a further reason why the mastermind might not just have thought it more profitable, but also more cautious, to diminish the level of the exporter's profit.

129. With yet further thought, the intelligent trader might have realised the reasonably obvious point that when no mobile phones were manufactured in the UK and moreover when phones with chargers with two-pin plugs would almost certainly have been imported into the UK fairly recently (with the fast-moving market), if the importer had duly paid UK VAT on importing the phones, it would inevitably have to follow that the foreign seller to that importer would have sold the phones to the UK importer at a very significantly lower price than the price at which the Appellant was expecting to sell the phones back to European customers. That again, with a bit of thought, would have made it clear that there was something distinctly odd with the very significant profit supposedly available to the Appellant, and indeed apparently available to the Appellant in countless past deals.

130. The Respondents also suggested that the mastermind would be reluctant to involve an innocent dupe in it its planned transactions because there would be a risk of the fraud being revealed to HMRC if an innocent party became suspicious. We accept that there is some credibility to this suggestion.

131. We are considerably influenced by the proposition that no evidence could be given as to how Rachaeltel had been located, and how these particular deals had originated. Even if (as we plainly conclude) these were matched deals offered to Declan Mundy by Mr. Hughes, we find it extraordinary that in 2006 and 2007, had there been innocent explanations for these deals, Mr. Hughes and Declan Mundy would not have discussed and recorded the full circumstances, so that they could be explained to us. We find it deeply suspicious that absolutely no detail in relation to the origin of deals involving £5.5 million, that must have been forefront in the minds of Mr. Hughes and Declan Mundy for years, could be given to us.

132. Reverting to the conceivable explanation that the parties either side of the Appellant might have simultaneously approached the Appellant, we note that in about 10% of its deals, the Appellant was acting as a buffer company between two UK traders, making therefore a minimal profit. While this was not a feature of the present deal, where the role of the contra-trader perhaps rendered buffer companies less significant, it seems extraordinarily unlikely that buffer companies can have participated in deal chains on any other basis than with full realisation that the deals were pre-arranged. For the risk of dealing on a deferred payment basis with companies with no credit standing, and when only making minimal profits cannot have attracted any participants unless they were fully aware of the pre-planning and thus the certainty that with no commercial risk, and correspondingly minimal VAT risk, they would inevitably make their fine margin of profit for nothing. Furthermore, with deal chains, the supposition that one particular participant (most obviously the exporter) might have participated by being duped by the parties either side of it can operate only once, and certainly cannot be advanced on behalf of every buffer company. Accordingly, once the Appellant had participated in a number of buffer deals, albeit that we were given no

information about these deals other than that the profits were indeed minimal, this further reinforces the belief that the Appellant simply cannot have remained innocent and ignorant.

133. We also consider it to be very extraordinary that at the end of May the Appellant made further supplies to Rachaeltel, when Rachaeltel had delayed making payment for the April 28 deal, and that deal was the first undertaken with Rachaeltel. We were told that there were repeated phone calls to the two customers (it being odd in any event that unrelated customers were both late in paying for their quite separate purchases) but we were not told what Rachaeltel had said in these numerous calls. Absent cogent reassurance by the mastermind, and the observation that the mastermind accepted that the Appellant did not have to pay Demravale until the customers had paid the Appellant, we find it difficult to conceive what could have been said by a new and innocent customer, in the shape of Rachaeltel, that would not have resulted in the Appellant deciding to have absolutely nothing to do with Rachaeltel again. Yet Rachaeltel was a purchaser in the aborted May deal.

134. The final very relevant fact in relation to the subject of actual knowledge is that, while we cannot assert without question whether it was Mr. Hughes or Declan Mundy who knew of the connection to fraud, or whether indeed both of them shared the knowledge, we incline to the view that Mr. Hughes's role may very well have been central. Declan Mundy said that this was one of Mr. Hughes' deals. Significantly he said that Mr. Hughes presented him with ***a matched deal*** for documentation. That meant documentation at a time when seemingly the Appellant had not previously even heard of Rachaeltel or made any enquiries in relation to it. It was Mr. Hughes who dealt with all the chasing when payments were to be reversed in relation to the May deals. Mr. Hughes' role was furthermore essentially that of being a "fixer" who located deals but otherwise attended to none of the checking or the documentation. Finally, we found Mr. Hughes to be a very unimpressive witness, whose word we did not trust.

135. Many of the factors that we are about to consider in relation to the second, "means of knowledge" aspect of the *Kittel* test greatly fortify our conclusion that the Appellant simply must have known of the connection of its deals to fraudulent VAT losses. In short, however, without further assistance from those points, we conclude that the Appellant simply had to be interposed into the transaction chain as in fact occurred. No innocent explanation was volunteered for how this was achieved. We have canvassed, and we believe rightly rejected, any other conceivable explanation for the role of the Appellant. We have examined other reasons why the mastermind would have been hesitant to use an innocent dupe. The feature that between them, neither director has been able to explain any of the missing facts in relation to the April, May and June deals is all bewildering, when it is inconceivable that between them they can have forgotten the steps that led to these deals being struck, and to Rachaeltel being located.

136. Our unhesitating conclusion is that the Appellant, through one or other if not both of its directors and most obviously through the role of Mr. Hughes, did know, because it absolutely had to have known, that its deals were connected to fraudulent VAT losses.

The "ought to have known" test

137. We also conclude that, were our above decision to be wrong, then nevertheless the Appellant ought to have known of the connection of its deals to VAT fraud.

138. In short, the factors that we consider to be particularly material to this conclusion are as follows:

- From 2002 and 2003, the Appellant, in the guise of both Mr. Hughes and Declan Mundy, was fully aware of the essence of, and the risks of being embroiled in, MTIC frauds.
- The very question posed to HMRC that we quoted in paragraph 27 above indicated that the Appellant was aware that even if its immediate trading partners were able to satisfy reasonable due diligence checks, the likelihood, save where the purchase was made from a contra-trader where the need for buffer companies had been dispensed with, was that the default would almost certainly be some or several steps away from the Appellant's supplier.
- That same letter to HMRC appeared almost to be setting the scene for the claim that the Appellant should escape the risk of having its claims for the refund of input tax denied simply by purportedly trading with a supplier that, with some credibility, the Appellant could suggest was a well-established and known supplier.
- The repeated answers in cross-examination to the effect that the Appellant was not remotely concerned when HMRC indicated that a trader, for which the Appellant had requested a VAT registration check, had later been de-registered, indicated that the Appellant was not paying genuine regard to the need to give deeper consideration to the overall viability of its transactions.
- The claims recorded in paragraph 28 above, that the Appellant always checked the VAT details of every supplier and customer on every occasion a transaction was done; that the Appellant only used reputable freight forwarders and always insured goods in transit; that it had copies of the insurance documentation; that it was thinking of acquiring a scanner to effect 100% checks of IMEI numbers, were all disregarded in the challenged transactions, and indeed in many other deals. Transactions were in fact often implemented before receipt of satisfactory VAT checks. Not only did the Appellant not insure goods dealt with through Coast, but the attention of the directors to ensuring that the claimed insurance was in place, was deficient in the double respect that neither director looked at the invoices from Coast, and certainly neither knew that the insurance policy excluded the carriage of mobile phones. Contrary to the implication, the Appellant had no control over which freight forwarders it used because inevitably the goods would continue to be handled by whichever freight forwarder already held the goods. In the event Coast was fraudulent. We actually doubt whether anything was checked at all, and certainly the inspection report, and all its "Yes" answers, was ridiculous. Evidence in relation to IMEI numbers came late in the day. And as to the final point mentioned in paragraph 28 above, Declan Mundy said that it was simply wrong to have said that 2 to 4 hours a day were spent doing checks. They were not.
- The due diligence checks carried out by the Appellant were well below standard. The Appellant never actually visited the premises, we believe, of a single supplier or customer. It ignored the feature, claimed by the Appellant to be irrelevant, but in fact vital, that none of its trading counter-parties had any material net worth or credit standing. It completely ignored giving any rational thought to why it was that the payment arrangements for every deal involved steps that avoided any party having to have any funds in advance to pay for anything, save for the exporter to have the funds to pay the "VAT gap" element of price, payable to the UK supplier.

- The trade terms were wholly unrealistic. Beyond the terms being skimpy, the only two indicated terms were not only wrong, but wrong for the deceitful reason that the stated terms had to obscure the reality of the transactions.
- The descriptions of product either ordered or offered were almost always deficient, and revealed that the parties were more interested in simply supplying anything than in paying close attention, as in a genuine business deal, to acquiring exactly what the Appellant wanted, or ensuring that it supplied to its customer exactly what the customer specifically demanded and expected to receive.
- Any intelligent trader would find it odd that the margin on selling to a UK purchaser was minimal, whilst a considerable profit could be made on selling for export. Similarly, if the earlier importer had duly paid the VAT (rather as one might imagine a *bona fide* trader would assume), that trader might wonder how it was that it was apparently to be able (and able in deal after deal) to sell product back to Europe at a price that would exceed the earlier importation price by the exporter's substantial margin, the margins taken by any buffer traders and all the costs of transport and insurance.
- The feature that deals often involved the sale of phones with chargers with two-pin plugs was a manifest "give-away" for the fact that there was no logical reason why there should be any available supply within the UK for such phones and chargers, let alone the vast availability of supply that in fact there was.

139. In short, we conclude that no trader, possessing the knowledge of MTIC fraud that the Appellant's directors had, could have traded in the manner that the Appellant traded without realising that these factors that we have listed, and probably several others, should have led the directors to the conclusion that there could be no other explanation for the transactions than that they were connected to fraud. This is a conclusion that both of the Appellant's directors should have reached. We conclude that their hope and expectation was that with some feigned due diligence and repeated claims that they were trying to assist HMRC to stamp out MTIC fraud, HMRC would continue, as they had done until April 2006, to refund VAT claimed. We have no hesitation in saying, on the second leg of the *Kittel* test, that the Appellant ought to have realised that there could be absolutely no explanation for its deals that that of connection to VAT fraud.

140. We accordingly decide both of the *Kittel* knowledge questions in favour of the Respondents and dismiss this Appeal.

141. For the reasons given in summarising the few largely undisputed facts in relation to the freight charges for which input deductions were also denied, we confirm that we also dismiss any appeal in relation to those input claims.

Costs

142. The Respondents asked for their costs in the event of their winning this Appeal as they have done. We note that the Appeal was commenced before the VAT and Duties Tribunal in 2007. Accordingly, and provided that the Respondents sought, and at some point received, a confirmation in Directions that the old costs rules should continue to apply to this Appeal that has spanned the date of the transition to the First-tier Tribunal regime, we grant the Respondents their costs, calculated on the ordinary basis.

Right of Appeal

143. This document contains full findings of fact and the reasons for our decision in relation to each appeal. Any party dissatisfied with the decision relevant to it 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

RELEASED: 21 October 2014