TC04091

Appeal number: TC/2009/13598

VAT – input tax – MTIC.

FIRST-TIER TRIBUNAL
TAX CHAMBER

TECHCOMP LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD BARLOW
MR RICHARD LAW

Sitting in public at London on 9, 11, 12, 13, 16, 17 and 19 September 2013 (written submissions received thereafter).

Mr Liban Ahmed of Controlled Tax Management Limited for the Appellant

Ms Jenny Goldring and Mr Howard Watkinson of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is the appeal of Techcomp Limited against the refusal by HMRC to repay input tax of £173,704.35 in respect of the monthly period 07/06 and £42,934.72 for the monthly period 08/06.

2. By way of introduction only, we mention that the appeal is what is called, in the jargon that has become well known through other appeals, an MTIC case, and the relevant transactions of the appellant are what are known as broker transactions in which recovery of input tax is denied on the basis that those transactions are connected with fraudulent transactions and the appellant either knew or should have known of that connection. In this decision in using the terms clean and dirty chains and broker or defaulter we do so only for convenience and, as has been pointed out before by the Tribunal (see the Decision in *Totel Distribution Ltd*), use of those terms, although now well understood, cannot be allowed to prejudge or influence the Tribunal's decision one way or the other as to the correct legal and factual position.

The legal issues.

3. In *Kittel –v- Belgium* [2008] STC 1537 the ECJ held that on the one hand, at [60], where a recipient of a supply buys goods and "did not and could not know that the transaction concerned was connected with fraud" then the Member State in which the recipient is registered for VAT cannot provide, by its domestic law, that such a transaction is void and cannot provide that input tax is not claimable on the transaction. On the other hand, at [61], the ECJ held that "where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that person entitlement to the right to deduct".

4. At [51] the ECJ had also held that a trader, who has taken every precaution to ensure that his transaction is not connected with fraud, must be allowed to claim input tax. At [52] the Court held that a person who "did not and could not" know that his transaction was connected with fraud would be entitled to claim input tax despite a connection between his transaction and a VAT fraud.

5. The Court did not explain specifically what it meant by "should have known" but [51] and [52] of the judgment suggest that a trader should take, at least, reasonable precautions to avoid being involved in a transaction connected with fraud. Taken literally "every precaution" and "could not know" might suggest that the test is a very strict one. But bearing in mind [56] to [58] of the judgment we do not read it in that way. The Court used the word "should" for the first time in paragraph [56] and explained the rationale of the rule it then set out at [61]. It said that the rationale was that a person who either knew or should have known of the connection with fraud is to be "regarded as a participant" and that he "aids the perpetrators"; which appears to suggest a degree of blame that would not have attached to a person simply for

overlooking a precaution that he might have taken or who could have known of a connection but only in some obscure way.

6. The Court also explained the underlying rationale of the rule in terms of its being for the better prevention of fraud.

7. It is well established that the right to deduct input tax is exercisable immediately when a transaction occurs and the ECJ emphasised this in *Kittel*. One consequence of that is that the applicable circumstances known to the appellant at the time of a transaction and the actions taken by the appellant at or before the transaction occurred are the relevant facts and that information acquired by the appellant subsequently will be irrelevant. Actions taken by the appellant after a transaction will also be irrelevant as such but, of course, they may shed light on what the appellant knew at the time if, for example, they appear to amount to attempts to cover up the true circumstances applying at the time of the transaction or they demonstrate a cavalier disregard to the possibility of being involved in fraud which was likely to have been present at the time of the relevant transactions as well as when those actions occurred.

8. The Court of Appeal judgment in *Mobilx and others –v- Revenue and Customs Commissioners* [2010] STC 1436 considered in detail the issues raised in cases of this sort and Moses LJ elaborated on the meaning of the "should have known" concept. He held that it is not enough for HMRC to prove that the circumstances were such that it was more likely than not that a transaction in question was connected with fraud and that what they must prove is that the transaction was connected with fraud.

9. Moses LJ also held that, where an issue arises about what a person should have known, it is relevant to consider whether the only reasonable explanation for the circumstances surrounding the transaction is that it is connected with fraud. He also stressed the relevance of circumstantial evidence generally.

10. The Tribunal was urged by Moses LJ not to over-elaborate the tests set out in *Kittel.*

11. The Courts have not thought it necessary to define what form the necessary connection between a clean chain transaction and the fraud must take.

The evidential issues.

12. The appellant admitted that the relevant transactions were in fact connected with fraud. The appeal therefore mainly turns on the question whether the Commissioners have proved on a balance of probabilities that the appellant should have known or did know that the transactions were connected with fraud.

13. We will make some preliminary remarks about certain issues relating to the evidence and then deal with the evidence itself.

14. Much of the evidence given by the Commissioners consisted of documentary evidence and a great deal of it related to parties other than the appellant which were involved in the transactions leading to the appellant's transactions and leading from

them, in other words the chains of transactions. The Commissioners argued that, as those chains were clearly contrived to a high degree, we should find that the people behind the frauds would have ensured that the appellant was aware of from whom goods should be bought and to whom they should be sold, in order to make sure the goods did not leave the fraudulent scheme and so could be recycled again and again in pursuance of the fraud. It is true that the fraud would work better if its organisers could find people in the position of the appellant who were willing to be knowingly involved to the degree that they would simply do what they were told to do in pursuance of the fraud.

15. But it is not impossible to imagine that the organisers of the fraud could find some way of orchestrating it without openly recruiting the appellant such as, for example, ensuring that the appellant was offered goods on favourable terms by persons involved in the fraud and at the same time requested by others to supply such goods, also on favourable terms, such that the deals were in fact structured as needed for the fraud to work. Indeed ultimately the appellant's case is that it was either tricked or targeted by the fraud's organisers but in a way that the appellant says was subtle enough to avoid a conclusion that it should have realised what was happening.

16. We do not agree with the Commissioners that the contrivance of the fraud's organisers can be sufficient in itself to prove that the appellant either knew or should have known of the connection with fraud. Although the 'should have known' concept clearly calls for an objective judgment by the tribunal, that judgment can only be based on what the appellant in fact knew or had turned a blind eye to or had unreasonably failed to find out about its transactions. It cannot be based solely on examining the actions of others in the fraud.

17. The appellant claimed that its actions were dissimilar to those of other MTIC traders to the extent that, for that reason, it should be judged not to have been knowingly involved in the fraud or that it should be concluded it has not been proved that it should have known the transactions were connected with fraud. For example, the appellant pointed out that the profit margins in the relevant transactions were not uniform, goods were sent to the United States to what the appellant claimed were legitimate traders and some defective items of goods were returned.

18. We hold that the appeal cannot be decided on the basis of dissimilarities with the facts of other MTIC traders' appeals any more than it could be decided on the basis of similarities. The issue is whether on the facts of this case the appellant knew or should have known the transactions were connected with fraud and if there are differences compared with other cases that cannot be determinative. Facts the appellant claims are differences may of course be relevant but their relevance cannot be judged just because they are different from the supposed usual case.

19. The Commissioners' case consisted, as we have already noted, mostly of the production and interpretation of documents many of which were not the appellant's documents. These will mostly be considered in light of the cross examination of the appellant's witness and many of them are of limited relevance or no relevance at all in

light of what we have said about the case not being decided on the basis of what would have been to the best advantage of the people behind the fraud.

The evidence

20. The Commissioners' first witness was Mr David Berry, officer, who was described as the broker officer dealing with Techcomp.

21. The reference to a broker means that the appellant was the exporter in transactions relating to goods that had been imported into the UK and then supplied through a chain of transactions leading to the appellant who then sold them to overseas buyers. The relevance of that is that the appellant bought the goods in supplies on which it was charged a tax inclusive price but as an export its supply was zero rated so that it was able to claim a repayment of input tax, being the tax charged by its supplier. Somewhere further up the chain a trader with whom the appellant did not deal directly failed to account for output tax. The appellant admits those failures to account for output tax occurred and that it was fraudulent but denies that it knew or should have known about the fraud.

22. Because the tax inclusive price paid by the appellant was more than the zero rated price at which the appellant sold the goods to its overseas customer the appellant was out of pocket immediately after it paid its supplier and will remain so until it recovers the input tax it has claimed and so will continue to be out of pocket if this appeal fails.

23. It is also the case that, as none of the suppliers in the chain added any value to the goods, for example by processing them, and as the prices throughout the chain were rising between each person involved only by small amounts (except for the appellant), the chain as a whole will contain an excess of funds if the input tax is repaid consisting of the difference between the input tax actually paid to the appellant and the output tax that should have been paid by the defaulting trader less the output tax accounted for by any of the interposed parties on their minimal profits. In other words the Commissioners will be the only losers and will have been the source of the proceeds of the fraud. If the input tax is not repaid the appellant will be the loser and will have been the source of the proceeds of the fraud.

24. We should note that the appellant accepted the accuracy of the facts relating to the transaction chains on which the previous paragraph is based. The identities of the so called buffer traders and the prices charged throughout the chains are not disputed nor is the fact of the evasion of output tax by the defaulting traders.

25. In respect of some but not all its relevant supplies the appellant paid its suppliers before it had been paid by its overseas customers. This is another difference the appellant says should distinguish it from the usual facts of a typical MTIC case. It was not suggested that any of the overseas customers failed to pay the appellant but we should note that in those cases where the appellant did pay its supplier before receiving payment from its customer the appellant was temporarily out of pocket to the tune of the whole of the tax inclusive price charged by its supplier and after

payment by its customer it remained and will remain out of pocket, if the appeal fails, to the tune of the input tax claim less its profit (and it will not have made that profit).

26. Mr Berry's evidence dealt with the setting up of Techcomp. The company was set up by Mr Nicholas Holmes and Mr Michael Westley and they were equal shareholders in the company at material times. An employee of the company also held shares in a different class of non-voting shares which gave him a right to dividends and that arrangement was described by Mr Holmes as being for tax reasons.

27. When Techcomp applied to register for VAT the VAT 1 application form stated that the estimated value of taxable supplies in the following twelve months was £400,000. The appellant wrote to the Commissioners about two months after it registered saying the value of supplies would be £24,000,000 and asked to be allowed to go onto monthly returns. The appellant was allowed to make monthly returns. We will deal with these points in more detail when we deal with Mr Holmes' evidence.

28. Subsequently it was put to Mr Berry that the £400,000 figure could have been a reference to UK to UK deals on the basis that the appellant had not realised that zero rated sales were taxable supplies. We would think that would be at least possible but as we will explain when we come to Mr Holmes' evidence his explanation was that the figure was or might have been a monthly figure although that was not put to Mr Berry. The form itself is specific that what is being requested is an annual figure.

29. When he was cross examined Mr Berry agreed that at the time when the £400,000 figure was put forward there was no evidence that the appellant had arranged funding for its trading. Subsequently a loan facility of £650,000 was obtained and we will deal later with what the appellant says that enable it to do.

30. Mr Berry was asked about transactions in November 2005 in which 15 out of 45 transactions traced to tax losses and were ones in which companies called Craner and Trans Global were suppliers. HMRC drew that fact to the appellant's attention and later the appellant wrote to HMRC saying it had made further checks on those companies and that it would be trading with Craner again on 1 August 2006 but that Trans Global had not been back in touch with it so it would not be trading with that company again.

31. In fact the appellant traded with Craner again in July 2006 and we will deal with this further when we consider Mr Holmes' evidence.

32. Mr Berry was asked about the fact that £46,000 input tax was allowed in respect of the periods under appeal and that Mr Holmes had said in his witness statement that these were in respect of clean chains but Mr Berry said that they were eight buffer deals which did trace back to defaulting traders and only one that did not. These transactions are not specifically under appeal as HMRC have not assessed the appelllant to recover the £46,000 but, as we have already noted, the appellant does now admit that the deal chains are as stated by the Commissioners and so Mr Holmes was wrong to say that these deals were in clean chains. We would note that we are

not thereby finding that the appellant knew these transactions were connected with fraud.

33. Mr Berry agreed when he was cross examined that on some occasions items were returned to the appellant as defective items though his evidence was that there were no returned items in respect of the transactions under appeal. He was also cross examined about the length of time between goods arriving in the UK and leaving the UK. He agreed that everything was not done in one day but that the longest span of time for the relevant deals was six days which he agreed was a "buck from the norm" in MTIC type cases but he added that most of the deals "happened over one or two days".

34. Mr Berry's evidence was that the relevant transactions were in sterling except those between Techcomp and Converge USA which were expressed in dollars. This has been suggested by the appellant to be outside the norm for MTIC broker transactions. Some of the triangulation deals which are not directly relevant to this appeal were not in sterling.

35. Mr Berry gave evidence that some deals had been done where goods had been "sold on" in what he thought was a contravention of the parties' retention of title clauses. The tribunal intervened to say that quite often in its experience the parties confuse the passing of title with relinquishment of possession or payment with passing of title. The parties to this appeal did not thereafter seek to rely on or to inquire into those issues and indeed there was little evidence given in this appeal about terms of business and whether any relevant parties had complied with them.

36. Mr Terence Mendes, officer, gave evidence about a company called Datec in which Mr Holmes and Mr Westley were employed. Mr Mendes had visited that company regularly between about 2001 and 2005 to verify its repayment claims. It is clear from his evidence that both Mr Westley and Mr Holmes knew that purchasing CPUs in the UK and selling them abroad would give rise to a claim to refund input tax.

37. Mr Mendes denied a claim made by Mr Holmes that he, Mr Mendes, had been impressed with the accounting system at Datec.

38. Mr Eran Milner, compliance officer for Intel, gave evidence about box numbers and the fact that individual Intel CPUs have unique numbers but he said that he had seen cases (it appears he has given evidence in a number of appeals) where typographical errors on transaction-related documents had made it impossible to identify with certainty what the correct number was.

39. He confirmed the existence of a grey market in CPUs and that it was "pretty extensive". He agreed with Mr Ahmed that the number of boxes concerned in this case would be a "drop in the ocean" of the grey market.

40. Dr Kevin Findlay gave evidence about the grey market in CPUs. Whilst we do not doubt the truthfulness of his evidence we found it to be of no help in deciding the actual size of that market and without that we cannot say that the Commissioners have

even been able to start to make out a case, as they had clearly hoped to do, that the appellant's transactions were too large to be part of the grey market. It does not follow that the appellant's transactions were part of a legitimate grey market. Such a finding would depend on examining evidence other than the size of the grey market.

41. Mr Peter Dean, officer, gave evidence about circularity of CPU boxes by which we mean boxes that had been exported from the UK and then came back to the UK. The significance of that fact is that it shows that those boxes were not sold to end users after their export. That in itself is not proof of fraud nor does it prove that the appellant knew or should have known its deals were connected with fraud. Given that the appellant admits the deals under appeal were connected with fraud this evidence has relatively little relevance to our decision.

42. We have already said why we do not accept that the proof of contrivance by the organisers of the fraud, even to a high degree, would be sufficient to prove the appellant knew or should have known of the connection and this evidence of circularity was introduced partly for that purpose.

43. However, the evidence of circularity is at least marginally relevant in two respects.

44. Firstly, there is evidence that one box was sold twice by the appellant. That refutes the appellant's claim that it had a system that would avoid such a possibility or rather at least refutes a claim that such system that it had was fully effective. On the other hand one box is of very limited relevance and the box in question was not traded in either of the tax periods under appeal.

45. Secondly some of the circularity involved the company Converge USA which the appellant sold goods to in the periods under appeal and the evidence of circularity goes towards refuting the appellant's claim that selling to Converge somehow guaranteed that the goods were not involved in the fraud from the time they were sold to that company. In effect the appellant has argued that, although it now recognises that the goods had been involved in fraudulent trades before reaching it, its own onward sales were legitimate sales to persons outside the fraudulent scheme. We find that the evidence of circularity shows that was not the case in those transactions where Converge were the buyer. Whether Converge were knowingly involved is not proven but it is clear that selling to Converge did not guarantee that the goods had left the fraudulent scheme. That in itself does not prove the appellant knew of the circularity or for that matter that Converge were or might be in the fraudulent scheme but it does refute the appellant's claim that the sales to Converge were normal sales in the legitimate grey market because those goods did in fact recirculate in the black market.

46. Officer Michael Kerrigan gave evidence about a criminal investigation and a case concerning an extensive enquiry called 'Operation Apparel'. Much of this evidence was directed towards proving that the deals in this case were contrived. We should note immediately that the directors of the appellant were not charged or even investigated as part of that enquiry.

47. Essentially, the evidence was that in pursuit of the investigation in that case the police and the Commissioners' officers were able to find and examine documents which showed exactly how the organisers of an enormous fraud had arranged to obtain a huge sum from the Commissioners in repayments of input tax while avoiding payment of output tax. An MTIC fraud in fact. The appellant's transactions were not specifically mentioned in those documents but they did show parts of the chains of transactions which led to the appellant's transactions. Also the documents showed that the persons organising the fraud must have known the financial details of the appellant's transactions because the 'profit' made by the fraud, which depended on the appellant's transactions, was calculated in a way that could only have been done if the organisers knew the outcome.

48. There is no evidence that the organisers actually contacted the appellant or that there was any way the appellant could have known about the organisers. This evidence is therefore more evidence that the frauds were well organised and very contrived but again we are not prepared to assume from that that the appellant must have been made aware of the fraud.

49. We now turn to the evidence of Mr Holmes who was the appellant's only witness.

50. Mr Holmes said that he had had 15 years' experience of trading in computer parts by the time of the transactions under appeal and he said that he had worked with Mr Westley in Datec until they were made redundant and decided to set up their own business.

51. He and Mr Westley applied to register for VAT and, as already mentioned, on the VAT 1 submitted on 1 September 2003 the taxable supplies expected in the following year were declared as £400,000. When asked about that Mr Holmes said that "we estimated from what I heard earlier, I think we put 400,000 down a month, that is what I assumed it would be per month, apparently it was per year is that correct?". His evidence about this was evasive. After saying he assumed it would be 400,000 a month he then said in reply to the question "you mentioned to the best of your recollection, you thought that was supposed to be a monthly figure"; "yes". He then almost immediately said that he "would suggest" it would be a monthly figure and then that it is "difficult to recollect". Then he added that he was "not involved in putting [the figure] in". Next he blamed Mr Westley who he said "may have gone in thinking that was all we were going to do but if we were going to turn over 400,000 we probably wouldn't have made much money".

52. Mr Holmes then added that it may have been that "it was thinking it was the taxable amount – the VAT possibly". That was, it appears, picking up a suggestion by Mr Ahmed that the error may have arisen from a failure to understand that taxable supplies include zero rated supplies. The judge asked what he took the term taxable supplies to mean and he said it was a bit difficult to answer that which we agree is a possible error a lay person might make but he then added "but that doesn't make much sense either to be honest".

53. Mr Westley was a director of the appellant and it is no answer by the appellant for it to blame him for this error. Mr Holmes clearly admitted that £400,000 a year was a clear underestimate even judged at the time of the application to register because, as he said, that would not have been a profitable turnover and his claim that the figure may have been a monthly one would have meant they expected the turnover would be £4,800,000 a year. The form itself is very clear that it is a year's figure that is being requested and although it has to be an estimate it was clearly under-stated. Asking ourselves why that might have been done we can only think that it was intended to avoid the suspicion that would probably have been raised in HMRC if the directors had declared an expected turnover of £4,800,000 which might have drawn more attention to the company than they wished.

54. Within two months of registration the appellant wrote to HMRC on 28 October 2003 saying its turnover was now going to be £24,000,000 and asked if the company could start making monthly returns. It is significant that this was before any transactions had occurred. At first Mr Holmes said he did not know what had changed to make him realise the turnover would be so much higher than declared. It is clear that the turnover was then being estimated at six times the earlier figure even if we accepted the explanation that the £400,000 figure was monthly. It is also clear that the £24,000,000 figure was based on a correct understanding that taxable supplies included zero rated supplies and Mr Holmes did not suggest any thing had happened between 1 September and 28 October to clarify his thinking about that.

55. Having said he did not know what had changed to make him want to correct the turnover figure Mr Holmes then said it was because the company had obtained an overdraft facility of £650,000. It became clear from his evidence that Mr Holmes was fully expecting to use the overdraft facility to carry out repeated transactions which the company would only need to finance for short periods before they could be repeated and that the £24,000,000 was based on those expectations.

56. The letter of 28 October was written shortly before the bank actually provided the finance and the company was only able to trade from after the finance was provided in November 2003.

57. Both Mr Holmes and Mr Westley had put their family homes up as collateral for the overdraft.

58. It is obvious from the above, and we find it to be the case, that the appellant and its directors knew that a large amount of business would be available to it from the outset. An overdraft facility of £650,000 would not have enabled it to take in stock and sell in the retail market on a scale anything like the £24,000,000 they now expected. Mr Holmes also admitted in evidence that it was intended that some of the trade would consist of buying goods and selling them abroad. He specifically said they intended to sell to Europe but mainly to the USA and the Far East. He also said they intended to buy and sell in Europe in what were clearly to be triangulation deals.

59. It was clear that the appellant would be claiming regular repayments of VAT and Mr Holmes admitted that would be the case. However, in the VAT 1 form the

appellant had declared that it did not expect to have regular repayment claims. Again, Mr Holmes blamed Mr Westley for a mistake and again we point out that is no answer for the appellant.

60. Mr Holmes wrote the letter of 28 October asking to be allowed to make monthly returns and amending the estimate of taxable supplies and in that letter he said that there would be repayment claims but they would be minimal. He was challenged on that and said "depends what you define as minimal, really at Datec we were reclaiming four million a month quite often, or a million here we are talking 200,000 something like that, 50, 100". That answer is more clever than convincing and we find that Mr Holmes was well aware that the company expected it would be making repayment claims which were well above a figure that anyone would call minimal for a newly formed business set up without any assets except an overdraft. We find that he made that statement in an attempt (which proved successful) to obtain HMRC's agreement to allow monthly returns. It follows, of course, that we can judge his evidence, in part at least, in light of the fact that we have therefore found him to be less than frank in his evidence to us.

61. We conclude that, before the appellant began trading, it knew that it would be selling goods obtained in the UK and sold abroad. It knew that it would be able to conduct such business on a large scale from the outset. It knew that its business would consist of repeatedly utilising its finance over short periods of time. It knew that it would be more successful if it could obtain its repayments from Revenue and Customs monthly rather than quarterly. It follows that it knew it would be using the VAT input tax as a source of finance.

62. We also conclude that through its directors the appellant sought to deceive HMRC in a way that demonstrates that, at the very least, the directors were aware that the method of trading they were proposing would be one about which HMRC would be suspicious.

63. Once the business got underway its trading method was to use the overdraft facility to the maximum amount of business that could be achieved and it was the finance available that put the limit on the amount rather than the availability of suppliers and customers. This became clear when Mr Holmes was describing how UK to UK deals with small profits were fitted in between the more lucrative export deals. He also said that those deals were undertaken when "we couldn't afford the VAT reclaim. We could only afford a certain amount". That made it plain that the company's business depended on the speed of repayments for the volume of its business.

64. It can also be inferred from that that it was expected that the transactions would occur in a short period of time with customers paying quickly and the company only needing to finance the VAT element of their payments to suppliers until repayments were obtained.

65. These facts also undermine the appellant's contention that it cannot have been involved in MTIC fraud because it paid its suppliers in full before it had been paid by

its customers. Although it was the case that the suppliers were often paid before the customers paid the appellant it was only for a few days that the company had to finance the full cost of the deal. It was however dependent on the VAT repayment for its profit.

66. It was put to Mr Holmes that the appellant had not added to the value of the goods. He agreed that was the case but said that the appellant's suppliers may have sold to the appellant because "possibly they couldn't afford to carry the VAT as well".

67. Mr Holmes said that sometimes the appellant would buy stock without having identified a buyer before the purchase but that even then the stock would only be held for two or three days before a buyer was found and then he added that the company had its own customers and did not often need to advertise. In effect he was saying that customers were always readily available for however much stock the appellant could purchase within its finance limits as already explained.

68. He claimed there had been negotiations with counter-parties and that he was not simply told to whom he should sell the goods. No actual evidence of negotiations was produced but we do not find that particularly surprising as, once the paperwork for the deal was put in place and the deal was completed, there would be no point in keeping any notes of the course of the negotiations.

69. HMRC had informed the appellant in November 2005 that some of its transactions had traced back to fraud. Two of its suppliers had made the relevant supplies and the appellant claimed to have carried out enquiries about them. One did not reply and the appellant ceased to trade with it. The other was a company called Craner. A firm of tax advisers wrote back saying that Craner had made due diligence enquiries about all its suppliers and had seen no reason to cease to trade with them which the appellant took to be sufficient to resume trade with Craner. The appellant told HMRC it would resume trading with Craner in August 2005 though in fact it resumed doing so in July 2005. The appellant does not claim to have made any enquiries itself and we regard it as an inadequate basis for it to claim to have taken all reasonable precautions when it resumed trading with Craner in those circumstances.

70. Despite that fact that the appellant had been involved in these chains where HMRC had notified it that fraud had occurred it later made declarations in statements made to other traders who were conducting due diligence on it that it had never been involved in a supply chain with a missing trader. Mr Holmes said Mr Westley had made that statement but he admitted Mr Westley "wasn't being totally honest with the truth" when he said that.

71. The appellant's due diligence on its suppliers was at best perfunctory and its due diligence on its customers was, on its own admission, non-existent. The appellant shipped very valuable goods to overseas customers without doing any due diligence on them at all. That is quite extraordinary in our view and it is no answer to that for the appellant to say, as it has done, that the goods were on hold so no risk was involved. The very least risk that could have occurred would be that the goods would

have to be shipped back to the UK at the appellant's expense if the buyer turned out to be unreliable and a new buyer found in what could be a falling market. Given the importance the appellant has attached to using its financial resources as frequently as possible such delays would also upset it business plan.

72. Despite his years of experience in the computer sales businesses Mr Holmes was unable to explain what gigahertz meant. He said he was a salesman not a "techie geek" and that he was never involved in what CPUs do. He said that the business was involved in selling CPUs according to their "spec code such as SL7Z9 et cetera".

73. Later he was questioned further on this point and expanded on the significance of the specification. In the periods directly relevant to this appeal the only CPUs sold in the relevant deals were SL7Z9 models. Some documents were produced in which errors of description were applied to these goods. For example, one transaction occurred in which the SL7Z9 model was said to be 3 GB 800MH. It was pointed out to Mr Holmes that 3GB was wrong and that it should have been 3GHertz. He admitted nobody had picked this error up and attributed it to incorrect inputting into the appellant's records. Once it had been incorrectly input the same error was repeated many times and it was not challenged or corrected either by the appellant or, it would seem, by its customers.

74. Mr Holmes repeatedly said that all his customers needed to know was that the goods were SL7Z9 items.

75. However, another error occurred in some of the documents in which the SL7Z9 was described as being 3.2GB. Not only was this incorrect because the GB should be GHertz but also the 3.2 GH description would have made the product in question an SL7Z8.

76. A yet further error occurred in some of the documents in which the description wrongly stated that the product was one megabyte when it should have been two. Mr Holmes noticed the error before it was pointed out to him in evidence. That somewhat undermined his evidence that he had simply not been aware of these errors at the time or the implication that his lack of knowledge had meant he would not have noticed them.

77. He then contradicted himself by adding that he was sure the errors would have been pointed out at the time of the transactions. No corrected documents were issued and we find that Mr Holmes was not telling the truth when he claimed this both because it might have been expected in view of the value of the goods in question that such corrections would be issued and because he contradicted his earlier evidence that the errors had not been noticed when he made this claim that the errors were pointed out.

78. In light of those errors it was put to Mr Holmes that nobody really cared about the paperwork because the transactions were undertaken to further the fraud. He denied that was the case.

79. It later emerged in the evidence that even if the customers knew exactly what the SL7Z9 components themselves consisted of there were two types of boxes one of which was for retail sales and one for wholesale and that some came with a fan and some did not so that knowing the code number did not tell the customer everything they might want to know.

80. Mr Holmes admitted in evidence that he now accepts that there was an overall fraud in which the appellant became involved and which he described as quite shocking.

81. He said that he now realised there had been "a bit of targeting" of his "perfectly decent business". Even with the benefit of now knowing that his company had been targeted, as he puts it, he was unable to offer any explanation of how the company had been targeted.

82. All the broker deals in the two periods under appeal traced back to defaulting traders. Many of the appellant's buffer deals and triangulation deals have also been involved in fraudulent chains and circular movements. Mr Holmes admitted that it has been shown that eight out of nine buffer deals and all the triangulation deals in the two periods under appeal have been shown to have been involved in fraud by reason of there being circularity in those chains.

83. We find that if the appellant had been targeted or in some way duped by the organisers of the fraud it is inconceivable that the methods they used would not be obvious at least with the benefit of hindsight and the fact that Mr Holmes cannot give any explanation of how it happened convinces us that that is not what happened.

84. On the contrary, Mr Holmes asserted that he had approached several suppliers, probably by instant messaging, when seeking to buy the goods featured in the broker deals in the two relevant periods. He placed some emphasis on the fact that the customers had been customers for a long time. We have already referred to the fact that the appellant never did any due diligence on its customers. We have also referred to the fact that it had resumed trading with Craner as a supplier after a question arose about that company and in circumstances in which we have found the appellant cannot have been adequately satisfied that that company had answered the questions that arose.

85. At one point in his evidence Mr Holmes said that the appellant had "probably lost lots of deals because we weren't interested in unless we had total control of where we buy and where we sell to". This appeared to be an admission that there had been cases where deals were offered in which it was proposed the appellant should deal with a particular party but when pressed further he said that he meant that the company would not have been in control of the price because negotiations fell through. He then claimed that in the past when he had been involved in Datec and another company called Comptech he had had calls from people offering to do a deal in which he was told from whom to buy and to whom to sell. He said that he had refused to be involved.

86. That admission showed that Mr Holmes must have been very well aware indeed of the possibility of becoming involved in fraud and indeed he said these were examples of his companies being targeted. He was also exceptionally aware of that from the fact that he had been arrested in connection with enquiries about Datec involving so called carousel fraud. We make it clear at once that he was not charged with any offence but the fact of his arrest is relevant to the question of how far he was aware of the possibility of fraud in the relevant business. The appellant was visited 18 times by customs officers between 2003 and January 2006. Again that shows how seriously the possibility of fraud must have been conveyed to the appellant's directors.

87. Mr Holmes' attitude to due diligence can be assessed from one answer he gave in his evidence. Asked by Ms Goldring: "Do you seriously suggest this is jumping through hoops of due diligence", he replied, "Well there's lots of bits of paperwork filled in yes". Mr Homes had repeatedly said the company jumped through hoops so far as due diligence was concerned. Ms Goldring's question followed a passage of evidence about a potential supplier company about which the appellant had carried out due diligence. Before the appellant first traded with the company Mr Westley visited and found that the proprietor was running the business from a small room in his parents' house. Unsigned accounts showed a turnover of £2.2 million. Although more was obtained later it appears that was all they had before their first deal with that company and Mr Holmes' only other explanation was that he had known the proprietor for some time apparently when he was at Datec.

88. "Lots of bits of paperwork filled in" clearly indicates that the appellant's attitude was to go through the motions rather than to jump through hoops where due diligence was concerned.

Conclusions

89. The appellant admits that all the relevant transactions were connected with fraud.

90. It is obvious, and we hold, that the appellant did not take every precaution reasonably open to it to avoid being caught up in transactions connected with fraud. Its failure to carry out any due diligence on its customers and to carry out adequate due diligence on its suppliers is sufficient to reach this conclusion.

91. We find that the appellant should have known the relevant transactions were connected with fraud.

92. That conclusion is based on consideration of all the evidence rather than any particular or individual piece of evidence or finding. Factors we consider to be of particular weight in so holding are as follows.

93. The appellant was able to find suppliers and buyers with ease and knew from before it started in business that there would be likely to be enough trade for the volume of trade to be limited only by the extent of its ability to finance the transactions.

94. The appellant took what appear to be serious risks by trading with customers about whom it had done no due diligence and suppliers about whom it had done inadequate due diligence. Given the value of the goods in question and the fact that the appellant was dependent on the customers paying quickly (especially when it paid its suppliers before the customers paid it) it is remarkable that experienced and intelligent businessmen should take those risks. The fact that they did take those risks suggests that they knew that somehow the transactions would always occur as planned and as they hoped and indeed that is what happened. The appellant should have known that its confidence that that would be the case was not based on normal business considerations.

95. The appellant's attitude to enquiries about Craner after it was informed that company had been involved (albeit perhaps innocently) in fraudulent transactions was cavalier at best.

96. If the appellant was targeted by fraudulent persons, as it claims was the case, then given that those persons evidently succeeded in respect of every one of the relevant transactions within the periods in dispute and many others in other periods, it is incredible that the appellant could have been targeted without it being the case that it should have realised it was being targeted. The methods used by the fraudulent persons must have been obvious. We find it incredible that the appellant cannot now identify the methods used with the benefit of hindsight and therefore conclude that it had not been an innocent dupe that had been targeted.

97. Although we have noted in paragraph 15 above that it would not be impossible to imagine a way in which the organisers could have duped the appellant without it being the case that the appellant should have realised it was being duped; our conclusion on the evidence actually given is that the appellant should have realised the transactions were connected with fraud. We reiterate that we are not basing that conclusion on the Commissioners' contention that the conclusion can be reached by examining the position from the fraudulent persons' point of view as opposed to that of the appellant.

98. The appellant's high degree of knowledge about fraud in the type of trade in which it was engaged is relevant to what it should have known.

99. We find that the appellant did in fact know that its transactions were connected with fraud. The points we have made above and the evidence as a whole are relevant to that finding. The appellant's lack of candour in making its VAT 1 application and the points of criticism of Mr Holmes' evidence also add to tipping the balance as far as the finding that the appellant knew rather than just that it should have known of the connection.

100. The appeal is dismissed.

101. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax

Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

RICHARD BARLOW
TRIBUNAL JUDGE

RELEASE DATE: 21 October 2014