TC04224

Appeal number: LON/2008/01138 & LON/2008/02070

VAT – MTIC fraud – Transactions of appellants connected to fraudulent loss of VAT – Whether appellants knew or should have known of connection – Yes – Appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

STARMILL UK LTD
STARMILL INTERNATIONAL LTD **Appellants**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS
MR NICHOLAS DEE

Sitting in public at the Royal Courts of Justice, London, on 4 – 7, 10 – 13 and 19 November 2014

Neil Mercer, instructed by Waller Pollins Goldstein Solicitors, for the Appellant

Jonathan Kinnear QC, Nicholas Chapman and Natasha Barnes, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. Starmill UK Limited ("SUK") and Starmill International Limited ("SIL") appeal against decisions of HM Revenue and Customs ("HMRC") denying them the right to deduct input tax of £2,882,355.88 and £8,807,596.01 respectively in relation to wholesale transactions or deals in mobile telephones.

2. At all material times SUK and SIL were managed and controlled by the same few individuals from the same location and were involved in the same type of trade. In the circumstances HMRC's contention that although separate corporate entities they should be regarded as indivisible for the purposes of the appeal was not disputed and their appeals were heard together in accordance with the direction of Judge Wallace released on 13 April 2011.

3. The input tax denied in SUK's case is £867,125 in relation to three transactions or deals in its 03/06 VAT accounting period; £1,011,368.75 in respect of two deals in its 04/06 VAT accounting period; and £1,003,862.13 in respect of three deals in its 05/06 VAT accounting period. SIL was denied the right to deduct input tax of £2,622,514.13 in respect of eight deals in its 03/06 VAT accounting period; £5,207,356.88 in respect of 16 deals in its 04/06 VAT accounting period; and £977,725 in respect of two deals its 05/06 VAT accounting period.

4. It is HMRC's case that each of the eight deals of SUK and 26 deals of SIL can be traced to a loss of VAT which is attributable to missing trader intra-community ("MTIC") fraud and that SUK and SIL either knew or, in the alternative, should have known that their deals were so connected.

5. Given the frequency in which MTIC fraud and its jargon has been described by the courts and tribunals we do not consider it necessary for us to provide yet another description or explanation here. However, should a description of this type of fraud be required, reference could be made to that adopted by Roth J at [1] – [3] of *POWA (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC).

6. It is accepted that in an MTIC appeal, such as the present, the Tribunal has to determine the following issues, as set out by Sir Andrew Morritt C at [29] of *Blue Sphere Global v HMRC* [2009] STC 2239:

(1) Was there a tax loss?

(2) If so, did this loss result from a fraudulent evasion?

(3) If there was a fraudulent evasion, were the appellant's transactions which were the subject of this appeal connected with that evasion? and

(4) If such a connection was established, did the appellant know or should it have known that its transactions were connected with a fraudulent evasion of VAT?

7. In the present case there was no challenge to HMRC's contention that the transactions undertaken by SUK and SIL during the periods concerned were

connected to a fraudulent loss of tax not only through "typical" or "basic" MTIC fraud but also via contra-trading and, insofar as these elements were not formally admitted, we find on the basis of the unchallenged evidence of HMRC that there was a tax loss, that it resulted from fraudulent evasion and that the transactions with which this appeal is concern are connected with that fraudulent evasion. Therefore the issue for us to determine is whether SUK and SIL knew or should have known of this.

8. Neil Mercer appeared for both SUK and SIL and HMRC was represented by Jonathan Kinnear QC, Nicholas Chapman and Natasha Barnes. Although throughout this decision we have referred to the respondents as HMRC this should be read, where appropriate, as a reference to HM Customs and Excise.

Law

9. It is not disputed that the burden of proof in this appeal is on HMRC and that the civil standard of proof, the balance of probabilities, applies.

10. There is also agreement on the law applicable in this case, namely Articles 167 and 168 of Council Directive 2006/112/EC of 28 November 2006 (previously Article 17 of the Directive 1977/388/EEC, the Sixth Directive). This has been implemented into UK domestic law by ss 24-26 Value Added Tax Act 1994 and Regulation 29 of the VAT Regulations 1995 under which an exporter is, in principle, entitled to claim a deduction of input tax. An exception to this right to deduct was identified by the European Court of Justice ("ECJ"), in the joint cases of *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04) [2006] ECR 1 – 6161 where the Court stated:

> "[51] … traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing the right to deduct the input VAT.
>
> …
>
> [56]. … a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
>
> [57] That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
>
> [58] In addition such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.
>
> [59] Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and do so even where the transaction in

> question meets the objective criteria which form the basis of the concept of "supply of goods effected by a taxable person acting as such" and "economic activity".
>
> …
>
> [61] … 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 the fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."

11. This decision was considered by the Court of Appeal in *Mobilx Ltd (in Administration) v HMRC; HMRC v Blue Sphere Global Ltd ("BSG"); Calltel Telecom Ltd and another v HMRC* [2010] STC 1436 [2010] EWCA Civ 517 ("*Mobilx*") where Moses LJ, giving the judgment of the court, said:

> "[59] The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> [60] The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

12. It is clear from *Mobile Export 365 v HMRC* [2007] EWHC 1737 (Ch), at [20], that when applying the *Kittel* test the Tribunal is entitled to rely on inferences drawn from the primary facts. It is also clear, from the approach taken by Christopher Clarke J in *Red12 v HMRC* [2010] STC 589 which was adopted by Moses LJ in *Mobilx* that the Tribunal should not unduly focus on whether a trader has acted with due diligence but consider the totality of the evidence.

13. In *Mobilx* Moses LJ said, at [83]:

> "… I can do no better than repeat the words of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563:-
>
> [109] "Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question

> forms part, as to its true nature e.g. that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.
>
> [110] To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> [111] Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them.'"

Evidence

14. We were provided with the witness statements of the following HMRC officers:

(1) Laurence Smith in respect of SUK;

(2) Patrick Limpkin whose evidence was in respect of SIL was to replace that of Officer Archibald but who had subsequently retired from HMRC. In making his statement Mr Limpkin had relied on the work undertaken and documents provided by Officer Iain Archibald and the evidence gathered by him and others in support of the original decision to deny the claim for input tax;

(3) Olabode Ayoola in regard to Morganrise Limited ("Morganrise");

(4) Michael Penry in relation to Headcom Limited ("Headcom");

(5) David Hancox in relation to N&B Traders Limited ("N&B");

(6) John Lyon in respect of Premiere Insurance Service Limited ("Premiere");

(7) Susan Okolo in connection with Mediawatch 360 Limited ("Mediawatch");

(8) Romaine Lewis in respect of Heathrow Business Solutions Limited ("HBS");

(9) Stewart Yule in regard to Phone IT (UK) Limited ("Phone IT");

(10) Phyllis Mee in respect of Lesspot Cleaning Service Limited ("Lesspot");

(11) Sally Medcroft in regard to Oracle (UK) Limited ("Oracle") and UK Communication Limited ("UK Comm");

(12) Michael Merriman in respect of GPA International Limited ("GPA");

(13) Susan Hirons concerning Prestige 29 UK Limited ("Prestige 29"):

(14) Douglas Armstrong in respect of KEP Limited ("KEP");

(15) Malcolm Orr in connection with Teknic Limited ("Teknic");

(16) Ian Simmons in respect the analysis of data and movement of funds in various accounts held at the First Curacao International Bank ("FCIB");

(17) Nigel Humphries who reviewed the deal sheets detailing the transaction chains of SIL in March and April of 2006;

(18) Michael Downer in respect of Dutch freight forwarder Worldwide Logistics BV; and

(19) Roderick Stone whose first statement consists of generic evidence relating to MTIC fraud but whose second is in relation to loans made to SUK and SIL.

Officers Smith and Limpkin gave oral evidence before us and were cross-examined by Mr Mercer.

15. Luay Alkasab, the director of both SUK and SIL, made four witness statements on their behalf. He also gave oral evidence and was cross-examined by Mr Kinnear.

16. Although many of the witness statement, particularly from HMRC's Officers, contain comment, opinion and what can only be described as submissions on the conclusions to be drawn from their evidence, we have adopted the approach of the Tribunal (Judges Walters QC and Berner) at [20] of *Megantic Services Ltd v HMRC* [2013] UKFTT 492 that:

> "… such expressions of view, on matters which it is for the tribunal to determine, did not amount to evidence to which the tribunal would have regard. … the tribunal itself is quite capable of distinguishing between the evidence on which a conclusion falls to be drawn by the tribunal and an attempt by a witness to draw that conclusion themselves."

17. In addition to the witness statements we were provided with extensive documentary evidence contained in over 100 lever arch files. However, as the parties had been able to narrow the issues between them prior to the hearing it was not necessary for us to refer to all of this material.

Facts

18. Other than the reason for the establishment of SIL, which has no material bearing on the case, there was no real dispute as to the following facts which we have adapted largely from HMRC's opening written submissions.

Background

19. Mr Alkasab came to the UK from Jordan in 1994, where he had been engaged in general trading in various "commodities", as an individual of independent means.

20. On his arrival in the UK Mr Alkasab initially bought, refurbished and re-sold properties but did not find this satisfactory due to a lack of personal involvement. He therefore sought other business activities and in 2000 his accountant introduced him to Sergio Chirkinian, his cousin Sarkis Chirkinian and Shiraz Vartanian. These three individuals produced a business plan to Mr Alkasab which involved the wholesale purchase and sale of mobile telephones. Having considered the proposed business Mr Alkasab decided to invest £250,000.

21. SUK was incorporated on 17 October 2000. Mr Alkasab became its director from its incorporation until 17 October 2001 and was reappointed director on 14 January 2002. He remains a director to the present day. Mr Alkasab was the usual signatory on the VAT returns and was actively involved in the day-to-day running of the company.

22. Mr Vartanian was a director and company secretary of SUK from 1 November 2000 until 7 January 2002. The company secretary from 28 November 2002 until 8 November 2006 was Adrian Loader.

23. Mr Alkasab holds 157 of the 1,000 issued shares in SUK, 68 shares are held by Sergio Chirkinian. The remaining 775 shares were originally held by Hollen Valkenaar but were subsequently transferred to Ibrahim Kattouah.

24. On 1 November 2000 SUK submitted an application to register for VAT to HMRC on form VAT1. It was signed by Mr Vartanian and declared that its main business activity was to be "Retail and Wholesale of Consumer Goods". However, on 5 October 2002 its trade classification was changed to "Telecommunications". SUK anticipated that its turnover for the 12 month period after registration would be £400,000. It was placed on monthly returns by HMRC.

25. On 3 January 2001 SUK notified HMRC that it was to commence wholesale trading in mobile telephones. There was a dramatic rise in its turnover in 2002 followed by a reduction in 2003 following the introduction of the Joint and Several liability measures in the Budget of April 2003.

26. SIL was incorporated on 8 November 2002 and shared its registered address and principal place of business with SUK. It registered for VAT with effect from 1 January 2003 and its VAT1, dated 28 November 2002, was signed by Mr Alkasab. This stated that SIl's intended business activity was "Trading in Communication Products" and anticipated its turnover for the first 12 months following registration to

be £50,000,000 with EU purchases and sales of £1,000,000 and £7,500,000 respectively. Regular VAT repayments were expected.

27. Mr Alkasab was appointed as a director of SIL on 28 November 2002 with Sergio Chirkinian and Sarkis Chirkinian being appointed as directors on 2 June 2003. Adrian Loader was the company secretary from 28 November 2002. 1,000 shares were issued with Hollen Valkenaar holding 600, Mr Alkasab 240 and Sergio Chirkinian and Sarkis Chirkinian 80 each.

28. Mr Alkasab explained that SUK and SIL were "always looking" for "investment opportunities" as a means to expand and diversify their business and drew the Tribunal's attention to the following:

(1) a transaction to purchase 15,000 telephones from the USA during a 45 day period. After receiving the first batch of 1,000 telephones the supplier refused to release the second and subsequent batches without a further payment on top of the $1,200,000 already paid. This led to litigation in the USA and although successful neither a repayment or goods were received;

(2) a joint venture with a "high end" fashion business in which the clothes, which were not insured, were stolen from the Oxford Street shop as it was being fitted out;

(3) a venture in large plasma screens which failed, leading to a large loss;

(4) a timber business in Sierra Leone was investigated but following a feasibility study was not considered practical;

(5) a venture into flat screen television monitors also failed; and

(6) A venture concerned with the reconstruction in Iraq which had to be abandoned when the road from Jordan became too dangerous and the US forces relocated the operation to Dubai.

Contact with HMRC

29. Having made an unannounced pre-registration visit to SUK on 23 November 2011 HMRC Officer Laurence Smith accompanied by another officer visited SUK at its principal place of business and met with Mr Vartanian and Mr Chirkinian (it is not recorded which Mr Chirkinian) on 26 January 2001. During that visit it was established that SUK was using freight forwarders Pauls Freight and Hawk Precision Logistics to hold and move its mobile telephones.

30. Officer Smith accepted that he adopted a "personable and friendly" approach when he visited SUK and that matters other than VAT, such as football, would be discussed with Mr Alkasab during such visits. He also accepted that he had never had any difficulty contacting the company. However, he said that he would not have provided advice on SUK's due diligence procedures or recommended Controlled Tax Management ("CTM") as able to assist with that due diligence but did agree that if he had been asked had if he had heard of CTM he would have said "Yes".

31. From 12 March 2001 SUK began to verify VAT registration numbers of prospective trading partners with HMRC's National Advice Service ("NAS") and did so on many subsequent occasions requesting verification of EU and UK VAT registration numbers. In addition written enquiries were made by SUK requesting verification of other traders' VAT registration numbers. On 13 August 2001 SUK requested the verification of a number of traders and commenced submitting monthly deal sheets to HMRC, showing details of its trade.

32. On 14 November 2001 HMRC wrote to SUK advising them that their supplier Offline Mobiles Ltd had been deregistered as it was a missing trader.

33. On 24 April 2002 Officer Smith and another HMRC officer visited SUK and met Mr Alkasab and Mr Chirkinian (again it is not clear which Mr Chirkinian) in relation to the trade carried out in the January to March 2002 VAT periods. The Memorandum of Understanding ("MOU"), of 1 March 2002, between HMRC and the mobile phone industry which set down a number of standards of behaviour that traders, including SUK, agreed to implement was also discussed during that visit. The MOU recognised that as at 1 March 2002 there was:

> … widespread acknowledgement by both the Mobile Phone Industry and [HMRC] that VAT fraud involving mobile phones [was] widespread and growing significantly.

The specific objective of the MOU was to reduce the level of that fraud and the distributors who were signatories agreed to "adhere" to the procedures set out in the "Code of Conduct" associated with and part of the MOU. Under this code of conduct they were to consider various factors before purchasing stock from a new supplier or selling to a new customer such as the length of time a supplier/customer has been trading, their knowledge of the industry, whether they are VAT registered, whether goods to be delivered to the country where the customer is resident or are they to be delivered to another country, and whether their bank account in a different town or country to their main business address? Reference was also made in the MOU to the recording of IMEI numbers, the unique number attributed to each mobile phone.

34. On 1 October 2002 HMRC notified SUK by way of two separate letters that export evidence that it had produced was false.

35. On 30 October 2002, HMRC wrote to SUK with a letter advising it of a change in their VAT status verification procedures. The letter stated that HMRC were still experiencing certain problems with businesses in the trade sector in which SUK was operating and requested the following information be provided with each request for verification of a traders VAT number:

(1) The name of the new or potential Customer/Supplier.

(2) Their VAT registration number.

(3) Their contact numbers (including telephone number, fax number, e-mail address and mobile numbers if known).

(4) The Directors and/or responsible members.

(5) Whether they were buying or selling goods.

(6) The nature of the goods.

(7) The quantities of the goods.

(8) The value of the goods.

(9) Their bank sort code and account number.

(10) A request to forward, on a monthly basis, a purchase and sales list with identifying VAT Registration Numbers against the suppliers/customers, to the trader's local VAT office.

36. A further letter in similar terms was issued to SIL by HMRC on 9 April 2003.

37. On 14 January 2003 Officer Smith visited SIL and spoke to Mr Alkasab who explained that he was a director of the company and that it had £750,000 of working capital. This comprised of a personal mortgage of £700,000 taken out by Mr Alkasab who had also injected £150,000 of his own funds. He said that SIL had no bank account at that stage, was to share business premises with SUK and was to trade in mobile telephones.

38. On 9 April 2003 HMRC sent a letter to SUK requesting that it verify VAT registration numbers of its trading partners with HMRC's Dorset House office.

39. On 11 April 2003 the relevant new Budget Notices, including that relating to Joint and Several Liability were sent to SUK which ceased trading until July 2003**.** On 12 May 2003 Officer Smith visited SUK and reviewed a number of documents including letters of introduction from potential trading partners and a number of forms designed to be used as part of SUK's due diligence.

40. By way of a letter dated 10 June 2003, HMRC were notified by SIL of a change in business to include the import/export/wholesale of consumer electrical goods, petroleum products and food products; and in December 2003 to include the import and dispatch of wholesale clothing, precious metal and gemstones and home entertainment products.

41. On 28 July 2003 HMRC wrote to SUK to inform it that from that date all future verifications were to be carried out through HMRC's Redhill office. The letter advised the SUK that:

> Missing Trader Intra-Community (MTIC) VAT fraud constitutes one of the most costly current forms of VAT fraud within the EU. It is a serious problem for the UK and is Customs' top VAT fraud priority.

The letter went on to state that the commodities typically associated with this fraud were computer chips and mobile telephones and that VAT losses from MTIC fraud in the UK alone were between £1.7 and £2.6 billion per year.

42. A similar letter was issued by HMRC to SUK on 15 June 2004 further advising about the risks in its trade sector and the tax losses resulting from the fraud.

43. On 29 September 2003 HMRC officers Laurence Smith and Katie Kumar visited SIL. During that visit Mr Alkasab stated that it was selling plasma screens. He also said that he had provided £400 funding for the company and Mr Valkenar had provided £45,000. On 1 December 2003 SIL wrote to HMRC stating that it was to going to be involved in the import and export of clothing, precious metals, gemstones and consumer home entertainment and that the trade classification "Telecommunications" was "no longer applicable".

44. On 28 December 2003 SIL wrote to HMRC to request a change from a quarterly to a monthly submission of its VAT returns for the VAT periods 08/03 onwards, initially on a quarterly basis "with immediate effect". The request was granted by HMRC and from January 2004 SIL submitted its VAT returns on a monthly basis.

45. Following a telephone call to HMRC from Mr Sergio Chirkinian on 13 February 2004 to request a meeting, HMRC officers visited SIL on 19 February 2004 and spoke to Mr Alkasab, Mr Vartanian and both Mr Chirkinians. At that time SIL was trading in Plasma televisions and platinum ingots having become involved in trading platinum after they met the director of a company called PGM Ltd ("PGM") in a public house. PGM were subsequently disallowed input tax that it had claimed, because the ingots were not genuine.

46. On 28 May 2004 Mr Sergio Chirkinian of SUK sent a fax to Office Rod Stone of HMRC in the following terms:

> Please find attached out VAT Verification Form complete with the information provided by both our Supplier and Buyer. Can you please verify the supply chain is ok or not.
>
> Can we and shall we proceed with the deal or not.
>
> I await your response in anticipation.

47. Officer Stone replied by way of a letter dated 3 June 2004 which stated:

> I should inform you that action in relation to tracing of transactions was reviewed in the light of the growing, incorrect, perception that this was being done as a service for businesses.
>
> Following this review, officers in the designated teams have been instructed to inform businesses of the correct position.
>
> Designated teams, such as the one at Redhill Business Centre, do, at times, trace proposed transaction chains. This is part of the overall MTIC strategy.
>
> However, Customs are bound by taxpayer confidentiality under the Finance Act 1989 s 182, along with Human Rights and Freedom of Information legislation.
>
> Information relating to other taxpayers can only lawfully be disclosed under specific circumstances, as defined by the Finance Act 1989, rather than at the request of a taxpayer.

> Customs can only confirm that supplied VAT registration details are correct and valid and that a supplied name and address matches the information held by Customs.
>
> Sometimes, for their own investigative purposes, Customs will attempt to verify the identity and validity of traders in a proposed transaction chain. This is not done for every proposed transaction, nor would it be possible or practicable to do so.
>
> If a missing or hi-jacked VAT registration is identified prior to a transaction taking place then Customs will inform the other known parties to the transaction that the VAT number is not valid to help them reach their own decision as to whether to continue with the transaction.
>
> If Customs do not identify a missing of hi-jacked trader this cannot be regarded as authorisation to enter into any transactions with any specific trader.
>
> Each business must make its own decision whether or not to deal with a supplier or customer. Customs cannot make that decision for them.
>
> I hope that this letter satisfactorily answers some of the point you may raise.

48. On 11 February 2005 Officer Smith together with Officer Copeland visited SUK and discussed the company's due diligence of its customers and suppliers including the checking of VAT registration numbers, credit references and checks and Companies House checks with Mr Alkasab and both Mr Chirkians. During this visit it became apparent that SUK had traded in CPU's and was conducting buffer deals. The outcome of the Bond House appeal to the ECJ was also raised by SUK.

49. By a letter dated 31 May 2005 HMRC warned SUK that its repayment for the 04/05 period was being released on a "without prejudice" basis.

50. On 15 November 2005 HMRC wrote to SIL to notify it that future verification of VAT registration numbers should be through its Redhill office and warned that:

> Although [HMRC] may validate VAT registration details, it does not serve to guarantee the status of suppliers and purchasers. Nor does it absolve traders from undertaking their own enquiries in relation to proposed transactions. It has always remained a trader's own commercial decision whether to participate in transactions or not and transactions may still fall to be verified for VAT purposes.

The letter also raised the risks associated with trading in mobile phones and included a copy of Public Notice 726, which provided considerable detail on MTIC fraud and the steps that businesses should consider undertaking to prevent them becoming involved.

51. On 1 December 2005 HMRC wrote to SIL advising of the need to keep comprehensive records in support of its trading activities.

52. During a visit on 2 December 2005 HMRC officers spoke to Mr Alkasab about the business activities of SIL. Mr Alkasab explained that SIL had been established as

SUK's VAT number had been hijacked and SIL could continue its trade if it was necessary to dissolve SUK. However, during cross-examination he said that SIL had started trading "because it was available and we wanted to make it active."

53. At the 2 December 2005 visit Mr Alkasab told the officers that SIL had not sold any mobile telephones or electrical goods but had traded in clothing. However, it was considering selling mobile telephones as it had not been paid by a customer in a clothing deal. A number of other matters including verification, third party payments and Joint and Several Liability were also discussed.

54. On 7 April 2006 officers of HMRC visited SIL to ascertain if it was still trading as the VAT returns for 12/05, 01/06 and 02/06 had declared no sales. However, it became clear during the visit that SIL had carried out £28.6 million of trade in mobile telephones during 03/06. Also during that visit Mr Alkasab informed the officers that SIL had appointed CTM to conduct due diligence visits on its behalf.

03/06 VAT Returns

55. Mr Alkasab signed the SUK 03/06 VAT Return which was dated 11 April 2006. It recorded sales of £12,930,070, including sales to the EU of £5,079,450. The output tax for the period was £1,373,858.50 and the input tax £2,239.424.04 leading to a repayment claim of £865,565.54.

56. During this period SUK carried out 10 deals, all of which involved mobile telephones. Three of the deals were broker deals with SUK purchasing from Xchange Communications Limited ("Xchange") in the UK and selling to Spabel Marketing ("Spabel") in Spain. These three deals have been traced back through the same chain to the defaulting trader, Oracle, which had purported to buy the phones from Stefani Trading in Latvia.

57. The remaining seven deals were buffer deals with SUK purchasing from a number of UK companies and selling to other UK companies. Five of the seven deals have been traced to a defaulting trader. Each deal involved the goods being sold to companies based in other EU countries. In three of the deals SUK's customer, Prism, sold to Spabel in Spain.

58. SIL's 03/06 VAT Return was dated 10 April 2006 and was signed by Adrian Loader. It recorded sales of £28,608,754, including sales to the EU of £15,349,868. The output tax for the period was £2,320,307 and the input tax £2,623,480 leading to a repayment claim of £303,172. Although SIL had not traded in the three months prior to March 2006 and £nil VAT returns had been submitted for 12/05, 01/06 and 02/06 Mr Alkasab said he was not particularly surprised at the increase in turnover from zero to over £28m in one month saying that he "thought business was becoming better."

59. During 03/06 SIL carried out 34 deals. Eight of the deals, all of which involved mobile telephones, were broker deals with SIL purchasing from Mobile Phone London Limited ("Mobile Phone") and Chatterbox in the UK and selling to Best in

Sweden and CZ International in Sweden and the Czech Republic respectively. All eight of these deals have been traced back to two defaulting traders Phone IT via S Electronic and Lesspot via DBP Trading Limited.

60. The remaining 26 deals were acquisition deals with SIL purchasing from EU-based companies and selling to UK-based companies.

04/06 VAT Returns

61. The SUK 04/06 VAT Return was signed by Mr Alkasab and dated 28 May 2006. It recorded sales of £17,692,769, including sales to the EU of £5,928,100. The output tax for the period was £2,087,162 and the input tax £3,096,231.41 leading to a claim for repayment of £1,009,069.41.

62. SUK carried out 11 deals in this period, which involved computer hard drives and mobile telephones. Two of the deals were broker deals with SUK purchasing directly from the Morganrise, which is accepted was a contra-trader, and selling to Spabel in Spain.

63. The remaining nine deals were buffer deals with SUK purchasing from a number of UK companies and selling to other UK companies. All nine of the deals have been traced back to either a defaulting trader or a contra-trader. Brokers at the end of these chains also sold to Spabel.

64. The SIL 04/06 VAT Return was signed by Adrian Loader and dated 30 May 2006. It recorded sales of £53,452,903, including sales to the EU of £28,808,653. The output tax for the period was £8,605,021 and the input tax £9,502,044 leading to a repayment claim of £897,023.

65. SIL carried out 33 deals in this period. 16 of the deals, involving mobile telephones and other electronic goods, were broker deals with SIL purchasing from Chatterbox, Urban Enterprises, Red House and Morganrise in the UK and selling to CZ International, Derastec Trade and RCCI in the Czech Republic, Spain and Cyprus respectively. Fifteen of these deals have been traced back to one of four defaulting traders, Prestige 29, GPA, KEP 2004 and UK Comm. In the final deal, SIL purchased the goods directly from Morganrise.

66. The remaining 17 deals were acquisition deals with SIL purchasing from EU based companies and selling to UK based companies.

05/06 VAT Returns

67. The SUK 05/06 return was again signed by Mr Alkasab and was dated 8 June 2006. It recorded sales of £21,547,982 including sales to the EU of £5,727,082. The output tax for the period was £2,768,941.88 and the input tax £3,770,732.01 leading to a repayment claim of £1,001,790.13.

68. During this period SUK carried out 20 deals which involved CPUs and mobile telephones. Three of the deals were broker deals, in two of which SUK purchased from Headcom and Caz Distribution Limited ("Caz") respectively and sold to IPS Enterprise in Switzerland. These transactions traced directly back to the defaulting traders Mediawatch and Teknic. In the third broker deal, SUK purchased the goods directly from Headcom, which is accepted to be a contra-trader, and sold to Derastec Trade ("Derastec") in Spain. The remaining 17 deals were buffer deals with SUK purchasing from a number of UK companies and selling to other UK companies with 16 of the deals having been traced back to a defaulting trader. The brokers at the end of the chains sold the goods to a number of EU-based companies.

69. The SIL 05/06 return was signed by Adrian Loader and dated 30 June 2006. It recorded sales of £5,726,650, all of which were sales to the EU. Accordingly there was no output tax. However, input tax of £981,666 was claimed leading to a claim for a repayment in the same amount.

70. SIL carried out two deals in this period, both of which involved mobile telephones and were broker deals. SIL purchased from Xchange and Headcom (acting as a buffer) in the UK and sold to Ergoelectronics in Spain. Both deals have been traced back to defaulting traders, Mediawatch 360 and Teknic.

Extended Verification

71. Following their submission the 03/06, 04/06 and 05/06 VAT returns by SUK and SIL were selected for extended verification by HMRC. Further information, including that relating to due diligence undertaken by SUK and SIL was requested by, and provided to, HMRC.

72. After consideration of this material and further correspondence between the parties HMRC wrote to SUK on 2 May 2008, 29 July 2009, 1 December and 22 May 2009 with its decisions denying SUK its right to deduct input tax for its 03/06, 04/06 and 05/06 VAT accounting periods. Similar decisions were made by HMRC denying SIL its right to deduct input tax for its 03/06, 04/06 and 05/06 VAT accounting periods and SIL was notified of this in a letter was from HMRC dated 29 September 2008. SUK appealed to the Tribunal against the decisions on 14 May 2008, 12 August 2008, 5 December 2008 and 21 July 2009. SIL appeals to the Tribunal were made on 3 October 2008.

Due diligence

73. Although Mr Alkasab explained that "we did to a great extent rely on our gut sentiment for due diligence" further due diligence was, in fact, undertaken. This included contact with a prospective supplier or customer, a standard questionnaire or checklist being sent to the potential trading partner for completion and return to either SUK or SIL and monthly meetings with CTM which had been instructed to visit and provide reports on suppliers. "Redhill" and "Europa" checks would also be made to verify the validity of the VAT registration number of a prospective supplier or customers.

74. The questionnaire or checklist which SUK and SIL sent to a potential supplier or customer sought confirmation from that it had:

(1) completed formal checks on suppliers and customers;

(2) made enquiries of the VAT office/Redhill;

(3) obtained and retained all relevant documentation;

(4) recorded IMEI numbers;

(5) obtained trade and financial references; and

(6) whether chains had ever involved missing traders.

75. Mr Alkasab explained that CTM had been instructed after "people in the industry" had asked if SUK were going to use CTM to undertake due diligence on its behalf. A visit by, and subsequent report from, CTM cost £500 and for logistical reasons CTM could not visit more than six companies a month. When asked during his examination in chief why CTM were instructed Mr Alkasab explained that "we have to do the things by how Customs wants us to do so we don't fall into the wrong stuff" by which he said he meant MTIC fraud in the industry.

76. As stated above, during the extended verification process SUK and SIL provided HMRC with the due diligence it had undertaken in relation to their suppliers and customers. Examples of the information provided are shown below.

77. In relation to Xchange which had supplied both SUK and SIL with the first purchase being made by SUK on 5 October 2005 the due diligence provided to HMRC contained:

(1) an undated Creditsafe report, which from the information in it could not have been obtained before 7 April 2006. This showed Xchange as being a dormant company with no credit limit;

(2) a CTM report dated 11 April 2006 which stated that the company had been trading since 2003 and had a monthly turnover of over £18m and that its director had reported that its due diligence "was not up to the requisite standard for the industry". CTM concluded that it did "not appear to have robust [due diligence] systems in place;

(3) a letter dated 23 May 2006 from Mr Alkasab to Xchange raising the issues contained in the CTM report;

(4) a further CTM report dated 21 June 2006 in which the monthly turnover of Xchange was recorded as rising to £150m;

(5) an application form completed by Xchange, dated 21 June 2006 stating that its annual turnover was £150 million per annum;

(6) a request dated 5 October 2005 to HMRC for verification of Xchange's VAT number;

(7) an undated letter of introduction from Xchange;

(8) Europa checks dated 16, 21 and 29 March 2006; and

(9) a copy of a letter dated 27 July 2006 from Mr Alkasab to Xchange informing them that he was suspending trade.

78. Mr Alkasab said that a Creditsafe report would have been obtained before a transaction had been undertaken but that "whenever we get a new [report] we get rid of the old one … because we would have a lot of Creditsafe reports on each company." However, he accepted that any previous report would have stated that Xchange was dormant and that he thought that meant "they are not trustworthy" but could not explain why SUK had nonetheless traded with Xchange. He also accepted that the CTM report of 21 June 2006 had "no value" in shaping the decision to trade with Xchange but said that the CTM report was "exaggerated, it wasn't that bad.".

79. On 11 May 2010 the director of Xchange, Mohammed Ahsan, was disqualified from being a director for a period of 11 years as a result of his involvement in MTIC fraud and causing losses of £39.3m to HMRC.

80. The due diligence on Morganrise which had also supplied both SUK and SIL in in deals carried out in their 04/06 VAT accounting periods consisted of the following:

(1) a cover sheet recording that first contact was made on 24 April 2006 and that the first deal took place on the same day;

(2) an introductory fax with documents attached;

(3) a Creditsafe report, which due to information stated in it cannot have been obtained before July 2006, showing Morganrise had no credit rating; and

(4) A CTM report dated 4th June 2006 which recorded a monthly turnover of £100 million.

81. Although SIL had undertaken transactions worth over £5m in total with Mobile Phone on 13 March 2006 and did not subsequently trade with it, SUK obtained a CTM report on the company, made after a visit on 11 April 2006. The report stated that the director of Mobile Phone had told CTM that he had stopped wholesale trading two weeks previously and claimed only minimal contact with SIL, amounting only to an exchange of introductory documents and a telephone call. The report also records in that someone from SUK or SIL had stated that the director of Mobile Phone may have been confused because there was another Starmill.

82. However, when asked about this in cross-examination Mr Alkasab said, "I can't comment on that."

83. Mr Alkasab wrote to CTM on 10 May 2006 stating that the conclusion was concerning and that trade with Mobile Phone would cease. The letter also stated that trading with Xchange and Text XS would be suspended. However, SUK and SIL continued to trade with Xchange. On 17 May 2006, SUK undertook a further deal with Xchange and continued to do so thereafter; SIL also conducted a further deal with Xchange on 24 May 2006.

84. The due diligence undertaken regarding Caz which had supplied SUK in deals carried out from 27 March 2006 consisted of the following:

(1) a cover sheet recording that first contact was made on 23 March 2006 and that the first deal took place on 24 March;

(2) a Company VAT registration check request dated 24 March 2006;

(3) a letter of introduction, undated, but with fax header dated 24 March 2006, accompanied by registration certificates and bank details;

(4) Europa checks on 24 and 29 March 2006;

(5) a Creditsafe report, undated, which shows a credit limit of £500;

(6) a completed SIL trading application form dated 25 May 2006;

(7) a CTM report dated 30 May 2006, which states Mobile Phone had a monthly turnover of £30 million and that it had two directors and no employees;

(8) photographs purportedly taken at the business premises of Mobile Phone; and

(9) a SIL trading application form indicating an annual turnover of £350m.

85. SUK and SIL were supplied by Headcom in deals carried out during their 05/06 VAT accounting periods. The due diligence undertaken consisted of the following:

(1) a cover sheet recording that first contact was made on 19 April 2006 and that the first deal took place in May 2006;

(2) an introductory fax dated 5 March 2005 and another similar document dated 16 March 2006;

(3) copies of Companies House and other official documents and trading application form, with a fax header dated 29 March 2006;

(4) a Creditsafe report showing it had no credit rating;

(5) a CTM report dated 23 March 2006 stating it reported a monthly turnover of £15m-25m and

(6) a Europa check dated on 30 May 2005.

86. The following are examples of the due diligence undertaken in relation to customers.

87. Spabel Marketing was SUK's customer in its three broker deals of March 2006, and its two broker deals in April 2006 with the first deal taking place on 16 March 2006. The due diligence consider of:

(1) a cover sheet stating that the first contact was on 14 March 2006 with the first deal on 21 March 2006;

(2) a letter from Spabel dated 18 May 2006 relating to its deregistration;

(3) a Redhill check dated 17 May 2006;

(4) a Europa check dated 21 March 2006; and

(5) a letter of introduction dated 15 March 2006 and various official documents;

88. Information from the Spanish authorities indicates that Spabel was a conduit company that had an office in a business centre and no warehouse. It was deregistered on 27 April 2006.

89. Derastec bought from SIL in April 2006 and SUK in May 2006. Due diligence undertaken consisted of:

(1) a cover sheet recording that initial contact was first made on 26 April 2006;

(2) a Europa check on 26 April 2006; and

(3) an introduction letter dated 27 April 2006, with various accompanying documents;

90. No information was provided about the standing of Derastec in the market. Information from the Spanish authorities revealed Derastec to be a missing trader that was deregistered on 12 March 2006.

91. In evidence, Mr Alkasab said that a credit report was not obtained on Spabel as the stock was not released until payment had been made. However, as it was an overseas company less due diligence was undertaken as "we were not concerned about VAT issues." He also said that with regard to overseas customers that the VAT number was verified via the Europa website and the deal as, "we don't have access to check on them, unless CTM is willing to go there; and each trip was will cost us £2,000 to do the CTM on that, and he doesn't have the time."

92. Although IMEI numbers had been recorded by SUK it had ceased to do so before its 03/06 VAT accounting period and therefore, for the periods with which this appeal is concerned no IMEI numbers were recorded. Mr Alkasab said that this was because a "client", whose identity he would not reveal, had told him that the IMEI numbers which had been scanned and recorded for SUK were being sold to other companies by an employee of a freight forwarder. However, he could not recall which freight forwarder this was but confirmed that SUK did subsequently deal with the same freight forwarder albeit without requesting the recording of IMEI numbers.

93. Mr Alkasab also said that either he or his son went to freight forwarders to inspect goods to ensure that it was "brand new" and in "excellent condition" as stock "that has been going around and around" will be "in a very bad condition."

FCIB

94. Almost every trader involved in the transactions chains of SUK and SIL, including SUK and SIL, had an FCIB account in which payments were made and received in pounds sterling irrespective of where in Europe the company was based.

95. In his witness statement and evidence in chief Mr Alkasab explained that although SUK had banked with Barclays and SIL with Bank of Scotland these accounts had been closed by the banks concerned and implied that this was the reason that SUK and SIL had opened FCIB accounts although he did say that he had been in "talks" with FCIB before the Barclays and Bank of Scotland accounts were closed.

96. However, during cross-examination he accepted that as the Barclays account was still open at the end of April 2006 and the Bank of Scotland account open until November 2006 the opening of accounts with FCIB by SUK and SIL had "nothing to do with the closing down of [the] other accounts." He also told the Tribunal that traders were saying "if you move to the FCIB, we'll do trades with you. If you don't move to the FCIB we don't want to make trades with you."

97. Mr Alkasab produced a document described as an FCIB "test key list". He explained that every time a transfer was made from either SUK's or SIL's FCIB account it was necessary to enter a number from the list, which could only be used once, to enable the transfer to be made. He said that although they had been given two paper test keys only one had been used no one and that was between himself and Mr Sergio Chirkinian. However, in answer to questions from the Tribunal Mr Alkasab said that Mr Sarkis Chirkinian would also have used the test key but only in the office.

98. HMRC officer Ian Simmons who had access to the records of the FCIB, including the electronic bank ledgers/statements as well as the account application forms and the material that was provided to support these applications, conducted a tracing exercise in relation to a sample of the deals of SUK and SIL. He analysed their FCIB accounts using sales and purchase invoices by taking the FCIB ledgers (bank statements) of SUK and SIL as a starting point to identify the payments that they had made and received in relation to each deal. He was then able to examine the ledgers relating to their customers and suppliers to trace the movement of the funds one step at a time. This process was repeated using the narratives contained on the bank statements to trace the payments.

99. It is accepted that in all of the deals examined by Officer Simmons there was a circularity of funds which occurred in a short space of time. In relation to one transaction there were movements of monies every three minutes from beginning to end of the circle. Mr Alkasab explained that for his part he would receive a telephone call from his customer, sometimes late at night, to say that payment had been made and that he would check that this was the case and then make the transfer to the supplier and follow this up with a telephone call to inform him that payment had been made.

Funding

100. The net effect of trading by SUK and SIL in the 3 months from March to May 2006 left them in a net repayment position of £4.9m. Their combined gross profits over the same period were approximately £1.6m leaving a negative cash position of approximately £3.2m. This shortfall between the sale price and purchase price of the

deals was met by payments to SUK by Mr Alkasab and loans from a Canadian entity, Quebec Inc. ("Quebec").

101. The following transfers, totalling £850,000, were made from a UBS, Jersey account held in the name of "Mr Luay A M Alkasab and Another" to the Barclays account of SUK:

(1) £150,000 on 16 March 2006;

(2) £350,000 on 4 April 2006;

(3) £250,000 on 5 April 2006; and

(4) £100,000 on 26 April 2006.

It appears that the bulk of this money was then transferred into the FCIB account of SUK to fund its trading.

102. In addition both SUK and SIL entered into loan agreements with Quebec under which:

(1) £415,000 was paid into the FCIB account of SIL on 5 May 2006;

(2) £874,000 was paid into the FCIB account of SUK on 16 May 2006;

(3) £610,000 was paid into the FCIB account of SUK on 24 May 2006; and

(4) £340,000 was on 24 May 2006, paid into the FCIB account of SIL on 24 May 2006.

103. In evidence Mr Alkasab said that SUK and SIL had had been "introduced" to Quebec by Sergio Chirkinian who told him that he had "some people" who would "finance the VAT". Initially Mr Alkasab suggested that Mr Chirkinian would "get a commission out of it" but subsequently denied this was the case saying that he had asked Mr Chirkinian about it and been told "there is nothing of the sort". However, Mr Alkasab was unable to explain why he had suggested a commission had been paid.

104. Asked who Quebec were Mr Alkasab said he did not know as "Serge talked to him" and that he, Mr Alkasab, had received an email and paperwork from a "French guy that lives in Canada."

105. The terms of the four Quebec loan agreements were, other than the parties concerned, amounts and dates, drafted in identical terms. These provided that the sums were lent at 8% interest per annum, did not include the provision of any form of security and contained the following clause:

> **Special Circumstances**
>
> Should the borrower be unable to discharge its liability to the lender due to non reimbursement to them by HMRC or such similar governmental body and or any of the borrowers client(s) shall default in payments if this is not caused by the negligence and or error of the borrower, meaning this was not meaningfully foreseeable, the

> borrower shall have no further claims on these monies subject to the borrower using their best endeavours to recover these funds

Mr Alkasab explained that he considered that this clause meant the "if we don't get the money from HMRC [ie the VAT repayment] we don't pay the loan" but accepted that had a loan been obtained from Barclays, as had been considered, such a clause would not have appeared and security would have been required. Mr Mercer accepted that the clause was incompetently drafted and could not have such an effect.

106. Although some interest had been paid on the loans Mr Alkasab said that payments had stopped two years ago as an agreement had been reached between "myself and the other party, which Serge was in contact with." Mr Alkasab was unable to remember the name of the "other party" despite calling him and reaching an agreement to wait for the outcome of this appeal following which he said "I will be contacted."

107. Quebec had a bank account with FCIB which it opened on 1 March 2006. From the FCIB documentation it appears that it was based in Montreal, Canada and controlled by a French national called Cyril Nathan Levy.

108. Analysis by Officer Simmons of the payments that were received by SUK and SIL from Quebec indicated that these form a further part of the circular movement of funds, often originating with trading entities with whom the SUK and SIL were already dealing.

Discussion

109. Mr Kinnear, for HMRC, contended that it is beyond coincidence that the Appellants should have purchased from 11 different suppliers in 67 deals and 62 should trace back to a tax loss. He submitted that it is explicable only in its context as part of an orchestrated and fraudulent scheme which could not operate without each party, including the SUK and SIL, knowing from whom to purchase, to whom to sell, whom to pay and when and argued that such a conclusion is supported by the FCIB evidence which establishes the frequent circularity of payments, with money starting and ending in the same bank account, having passed through numerous others, often in a very short period of time. He also relied on the fact that none of the goods remained within the UK having been brought into the UK from elsewhere in the EU and in short order dispatched back to the EU.

110. For SUK and SIL Mr Mercer accepted that they, through Mr Alkasab, had knowledge of MTIC fraud and its prevalence at the time of the transactions but submitted that Mr Alkasab was a credible witness who did not and could not know of the existence of the fraud. He, and therefore SUK and SIL, were not "typical" MTIC traders with little or no experience who made substantial profits without capital from a standing start. Rather they were the complete opposite, experienced traders with substantial capital who were in frequent contact with HMRC, having a good relationship with Officer Laurence Smith in particular. They also made voluntary disclosures and attempted to "line check". In addition they used CTM for due

diligence purposes and the FCIB account was not used by any unauthorised person either within or outside SUK and SIL.

111. Given Mr Mercer's acceptance that SUK and SIL knew of the existence and prevalence of MTIC at the time of the transactions with which we are concerned it is not necessary for us to consider Mr Alkasab's awareness and knowledge of the extent of MTIC fraud in 2006. However if it were, we would have no hesitation in concluding that, as a result of the correspondence and visits from HMRC Mr Alkasab, and therefore SUK and SIL were well aware of the prevalence of MTIC fraud within their trade sector , at the time the transactions with which this appeal is concerned took place. Also both companies would have been aware from HMRC's letter of 3 June 2004 that HMRC did not undertake "line checks" and that each business "must make its own decision whether or not to deal with a supplier or customer[as HMRC] cannot make that decision for them" (see paragraph 47, above).

112. As to whether SUK and SIL knew of the connection to fraudulent loss of VAT Mr Kinnear contended that the only way a trader without knowledge of the connection to fraud could operate within a contrived scheme would be if it was an "innocent dupe" being manipulated into buying and selling to the right people at the right price in the right type and quantity of goods and that this would be an inherently difficult situation to control and would carry considerable risk that the manipulation would fail and the scheme frustrated with the circularity identified in the FCIB accounts being lost.

113. Mr Mercer submitted that SUK and SIL were indeed innocent dupes who were been controlled or manipulated by the fraudsters. He argued that the fraudsters could very easily contrive trade with SUK or SIL without telling them what they were doing by telephoning either company in the morning with a request for a particular amount of stock and then call back, using a different identity later in the morning offering that stock. Even if they had done it the other way around and offered stock first, they could still control the chain by not releasing it if the "wrong buyer" were inadvertently selected by SUK or SIL.

114. Additionally Mr Mercer contended that it could be advantageous for a fraudster to manoeuvre an innocent party into acting as a broker for a number of reasons, for example they may have wanted fresh capital or camouflage for their activities and by having an innocent third party they were able to add legitimacy to their fraud. He also suggested that there may be other unknown reasons, which have not been thought of by HMRC, which would benefit the fraudsters to have the SUK and SIL as their innocent dupes in this scheme.

115. While we do not completely rule out the possibility that an innocent dupe could be manipulated into making transactions in this case it appears, as Christopher Clark J observed in *Red12*, unlikely to be "a result of innocent coincidence" given that in their 03/06, 04/06 and 05/06 VAT accounting periods SUK and SIL between them undertook 34 broker deals, all of which traced back to a defaulting trader or a contra-trader and 33 buffer deals, 28 of which have been traced back to a defaulting trader or

a contra-trader, in which they purchased from 11 different suppliers and sold to 15 different customers.

116. We therefore discount the possibility that SUK and SIL could be innocent dupes in the transactions with which we are concerned and find support for such a conclusion in the timing and speed of the movement of funds through the FCIB accounts in which SUK and SIL clearly played their part.

117. Given the timing of the movement of funds through the FCIB accounts of the participants it would seem highly improbable, if not impossible, for these to be arms-length commercial transactions between unconnected parties. Indeed the evidence leads us to conclude that there was a contrived scheme for the fraudulent evasion of VAT with each of the deals having been pre-arranged. In our judgment it is extremely unlikely that the payments through the FCIB accounts could have been made without the knowledge of the fraud by each of the participants, including SUK and SIL, for it to have been possible to ensure that payments were made on time and in the correct order to complete their circularity.

118. We find further support for our conclusion from the Quebec loans to SUK and SIL. All Mr Alkasab appeared to know about Quebec was that Sergio Chirkinian was "eager" to borrow money from it and that it was run by a "French guy that lives in Canada". Yet it was not only willing to lend SUK and SIL between them over £2.2m but also agree to a wholly uncommercial "special circumstances" clause (which we have set out at paragraph 105, above) which, according to Mr Alkasab meant that if repayment of input tax was not received from HMRC SUK and SIL would not be under any obligation to repay Quebec!

119. Clearly there would be not be any need for a knowing participant in the deals to undertake any effective or thorough due diligence and this would explain why trading took place despite, for example, Mr Alkasab agreeing that the Creditsafe report showing Xchange to be dormant meant the company was "not trustworthy" and his failure to explain why SUK had nonetheless traded with it. It would also explain why CTM visits and reports were made after a deal had taken place as it did, for example, in the case of Mobile Phone from which SIL had made purchases of over £5m on 13 March 2006. Not only did the visit by CTM take place on 11 April 2006 but its subsequent report stated that that the director of Mobile Phone claimed to have had "only minimal contact" with SIL.

120. Being knowing participants in a fraud would also explain the increase in in the turnover of SUK and SIL, particularly the exponential increase from £0 to over £28m by SIL in its 03/06 VAT period and why, despite the business failures to which he drew our attention (see paragraph 28, above) Mr Alkasab was not surprised by the level of turnover achieved.

121. However, even if SUK and SIL were not knowing participants in the fraud we find, for the above reasons, but in particular the way the funds circulated through the FCIB accounts and the uncommercial nature of the Quebec loans, that the only reasonable explanation for their transactions was that they were connected with the

fraudulent evasion of VAT and that Mr Alkasab, SUK and SIL should have known that this was the case.

122. We therefore find that HMRC were correct to deny the input tax claim of SUK and SIL.

Decision

123. For the above reasons the appeals are dismissed.

Right to Apply for Permission to Appeal

124. 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.

JOHN BROOKS
TRIBUNAL JUDGE

RELEASE DATE: 12 January 2015