



**Appeal number FTC/26/2010
NCN 2012 UKUT 50 TCC**

VALUE ADDED TAX – input tax – MTIC and contra-trading – whether connection to fraudulent trading as condition of denial of right to deduct input tax requires privity of contract with fraudulent trader - test in Kittel and Recolta Recycling – whether English mistranslation of French text of the judgment – whether to refer question to ECJ – application of Court of Appeal judgment in Mobilx

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

POWA (JERSEY) LIMITED

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS**

Respondents

TRIBUNAL: MR JUSTICE ROTH

Sitting in public at the Royal Courts of Justice on 20, 21 and 22 June 2011

Mr Michael Patchett-Joyce, instructed by PM & M Accountants, for the Appellant

Mr James Puzey, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

Decision

This is an appeal from the decision of the First Tier Tribunal (“FTT”) (Judges Colin Bishopp and Peter Whitehead) dismissing the appeal of POWA (Jersey) Ltd (“PJM”) from the decisions of the respondents (“HMRC”) disallowing almost all of its claim for credit for input VAT in the accounting period 06/06. The claims disallowed concerned 37 purchase transactions and the total amount refused was just over £1 million.

1. This is yet a further case of so-called missing trader or “MTIC” fraud on the system of VAT. The decision of the FTT conveniently describes the nature of a typical MTIC fraud as follows:

“5. ... goods (almost always small but valuable items such as mobile phones and computer chips) are acquired by a registered trader in the United Kingdom from a trader in another member State, and sold to a second UK-registered trader. The goods then usually change hands several times within the UK before they are sold to an overseas trader which, if it is located in a member State of the European Union, is registered for VAT in that member State. Commonly the transactions all occur within a few days of the entry of the goods into the UK, sometimes even on the same day, so that goods enter the UK in the morning, pass through the hands of several UK traders during the day, and are exported again in the afternoon.

6. The first UK vendor, the acquirer from overseas, charges VAT on the consideration paid by his purchaser, but fails to account to the respondent Commissioners for that tax, and disappears. Such documentation as he may have had—if any—relating to his acquisition is never produced to the Commissioners. For the scheme to work he must be a VAT-registered trader who provides the purchaser with a genuine VAT invoice, on the strength of which the purchaser claims an input tax credit. The purchaser’s own sale, and those of the other UK traders save the last in the sequence, usually generate a small profit and, consequently, a small net VAT liability, for which those traders account. The last trader, selling overseas, claims credit for the input tax he has incurred, but has no output tax liability since the sale is zero-rated. Usually this trader makes a significant profit, though that is not invariably the case; occasionally one of the antecedent traders can be shown to have made the greatest profit of all those in the chain. All of these sales and purchases, including the sale to the overseas buyer, are almost always properly documented.”

2. In the jargon that has developed to describe the various participants in such chains, the initial importer of the goods, who fails to account for the output tax he has

charged to his purchaser and disappears, is known as the “defaulter” or “missing trader”. The trader at the end of the UK chain who sells the goods to a purchaser overseas is known as a “broker”. The traders between the defaulter and broker are referred to as “buffers”. In the present case, it is alleged that PJJ was a broker.

3. There are various variations and developments of this typical scheme of MTIC fraud. One of these, of which three of the transactions in the present case are said to be an example, comprises what is called “contra-trading”. I again gratefully adopt the description given by the FTT:

“9. A contra-trader, a broker in one chain of transactions—again adopting the commonly used jargon, a “dirty” chain—in which a default has occurred, buys goods from a supplier in another member State, and sells them to a UK customer; after one or more further sales and purchases they are sold to a customer in another member State. The contra-trader and, usually, all the other traders in this chain account correctly for their VAT liabilities; taken by itself it is a “clean” chain. The acquirer in the clean chain has incurred a liability for output tax which (because the values are engineered to achieve this result) matches the input tax credit due to him (or ostensibly due to him) as the broker in the dirty chain. He does not need to make a large repayment claim, attracting the Commissioners’ attention, but instead makes a modest payment, or a minimal repayment claim. The same result may be achieved by undertaking a number of transactions generating an aggregate input tax credit matching the broker’s output tax liability for the relevant accounting period. It is then the broker in the clean chain who has an input tax claim which, unless they can establish a link between the clean and dirty chains, the Commissioners must meet since the goods in the clean chain have not themselves been used for fraudulent purposes.”

The findings of the FTT

4. I summarise the relevant facts as found by the FTT¹.
5. PJJ was incorporated in Jersey on 1 August 2002. However, it was dormant for several years and commenced trading only in January or February 2006. POWA (Ireland) Ltd, an Irish company in related ownership and with the same directors as PJJ, was engaged in trading computer chips on the so-called “grey” market. That is a market in which small original equipment manufacturers (“OEMs”) who are unable to achieve savings by buying in bulk direct from manufacturers of computer chips, and also some retailers selling chips individually for use by consumers building their own computers, bought their supplies. PJJ was struck off the register of companies for failure to file accounts and ceased trading in about January 2006. PJJ effectively

¹ All paragraph references are to the FTT decision, save as otherwise stated.

took over trading in the grey market from PIL. The FTT found that PJJ “seamlessly carried on where PIL had left off”: para 53.

6. PJJ’s first VAT return was for the three months period 03/06. It was a return seeking repayment and the sum claimed was paid by HMRC without extended verification. PJJ’s second return was for the period 06/06 and it was that return, claiming a repayment in excess of £1 million, that prompted the extended verification enquiries which led to the decisions by HMRC under challenge.
7. In none of the 37 relevant transactions did PJJ sell from any stock which it may have taken over from PIL. In each case, its sale was made of goods that it had purchased to fulfil that order. In each case, the sale by PJJ was to a customer overseas and was accordingly zero rated.
8. The chain of transactions which led to these eventual purchases and sales by PJJ in each case was traced by HMRC. They showed that the goods had passed through several purchasers and re-sellers within a matter of days, and sometimes within a single day. In many of those chains, the traders in the chain prior to PJJ made minute profits, sometimes marking up the chips by only a few pence each.
9. In none of the chains was there a trader which PJJ could identify as a manufacturer or an authorised supplier that might have a surplus of chips bought for their intended purpose of being used in the manufacture of computers, nor a trader that might itself have a need for chips.
10. It is helpful to reproduce the description set out by the FTT of one set of transactions established by HMRC’s investigations:

“65. ... a German company sold 2,600 chips to a trader which had hijacked the identity of a company known as KEP 2004 Ltd (at least, KEP 2004 claimed that its identity had been hijacked; Mr Patchett-Joyce, in our view rightly, suggested that the claim was false). On the same day the (purported) KEP 2004 sold all of the chips to Time Corporates Ltd, but in two transactions, one in respect of 2,000 chips and the other in respect of the remaining 600. The parcel of 2,000 chips was then sold successively to Resolutions (UK) Ltd, Nirvana Trading Ltd, Bluestar Trading Ltd, Micropoint (UK) Ltd, Megantic Services Ltd, Rapid Global Ltd and Techcomp Ltd. The other 600 were sold successively to Resolutions (UK) Ltd, Nirvana Trading Ltd, RS23 Ltd, The Fones Centre Ltd, Grandbyte Computers Ltd and Techcomp Ltd. Techcomp then sold all the chips, but still in two parcels of 2,000 and 600, to PJJ which sold the entire 2,600, in a single transaction, to a Danish customer. The documents ... show that all of the transactions, from start to finish, took place on a single day, 6 April 2006. It follows that within the space of 24 hours, the goods had entered the UK from Germany, had passed through

the hands of, in one case, 10 and, in the other, nine UK traders, and had then been sent to Denmark”

11. In the contra-trading chains, there was the same feature of computer chips rapidly changing hands after they arrived in the UK at the beginning of the day before they were exported at the end of the day. The contra-traders sought to offset large output tax liabilities against closely matching input tax credits. The purpose of the contra-traders was the fraudulent evasion of VAT.

12. The FTT summarised the overall character of the trading chains as follows, at para 122:

“The significant features, appearing over and over again, are the hijacking of identities (or the false claims of hijacking), the making of third party payments, the speed with which numerous transactions between recently established and inexperienced traders took place, the similarities between many of the chains, the complete absence of any manufacturers, authorised distributors, retailers or OEMs from the chains, the entry of the goods into the UK in the morning followed by their departure in the afternoon and the apparent absence of any trading risk.”

13. In the end, it was accepted by Mr Patchett-Joyce on behalf of PJJ before the FTT that the evidence of fraud in the earlier part of the chains was compelling. Accordingly, adopting the parlance used for MTIC fraud, PJJ was the broker.

14. The hearing before the FTT lasted 15 days. The FTT had some 13,000 pages of evidence and over 25 witnesses gave oral evidence. Of those witnesses, however, only two gave evidence on behalf of PJJ: Mr Philip Woods, its financial controller, and Mr Michael Chater, its general manager. Both had fulfilled similar functions in PJJ. None of the directors of PJJ gave evidence, nor did a Mrs Pauline Bennett who was the individual employee who negotiated the relevant sales and purchases under the remote supervision of Mr Chater, who appeared to have spent nearly all of his time overseas. The FTT was told that Mrs Bennett had subsequently left PJJ’s employment in circumstances that led to significant bitterness.

15. The FTT found that Mr Chater’s evidence was vague and sometimes evasive and that his explanation regarding certain transactions was untrue: paras 73 and 105. It found that there was no “cogent and plausible evidence” regarding the manner in which PJJ’s trade was conducted: para 129. Further, PJJ, through Mr Chater, showed little concern about the condition of the chips themselves in the boxes in which they were delivered. The FTT rejected his evidence about PJJ’s inspection reports as “incredible” and found that:

“he knew this was not a genuine market in which chips would eventually reach an OEM.”: para 130.

16. On a close analysis of all the evidence regarding the way in which the transactions were handled, the FTT found that the due diligence undertaken by PJJ regarding the transactions was “limited in extent and consequently in its value; it was casual and formulaic”: para 91.
17. As to Mr Woods, the FTT did not accept that he was a witness of truth: paras 38, and 45-47.
18. The FTT summarised its findings as follows, at para 132:

“we are satisfied that PJJ went into what its directors, as well as Mr Woods and Mr Chater, knew was an artificial market intending to profit from it. ... Mr Chater and Mr Woods either knew that [PJJ] was entering into transactions connected with the fraudulent evasion of VAT or had the means of knowing of the connection but closed their eyes to it.”
19. On this basis, applying what it understood to be the test deriving from the leading authority in the European Court of Justice (“ECJ”), Cases C-439/04 and C-440/04 *Kittel and Recolta Recycling* [2006] ECR I-6161, the FTT determined that HMRC were correct in refusing to permit PJJ to deduct the input tax which it had incurred.

Lack of privity

20. It was not alleged that PJJ was itself fraudulent or that, in any of the 37 relevant transactions, PJJ bought directly from a fraudulent trader. The FTT held that this did not preclude disallowance of the claim for credit in respect of input tax. At the forefront of his submissions on this appeal, Mr Patchett-Joyce strongly challenged that holding. He submitted that on a proper analysis of the ECJ jurisprudence, even if a trader should have known that there was fraud in a transaction or transactions higher up in the chain, that was not a ground on which its claim for repayment of input tax could be denied since in those circumstances it was not sufficiently involved in the frauds.
21. This argument turned in particular on the articulation of the relevant test by the ECJ in *Kittel*.
22. The judgment in *Kittel* was in fact on two joined cases, both references from the Belgian courts. In the first, a Belgian company (Computime) bought computer components which it resold abroad and then sought repayment of input tax. The Belgian court found that the supplies made to Computime were fictitious and that Computime was aware of the fraudulent scheme whereby its supplier in Belgium never paid VAT. In the second case, the seller of luxury vehicles to, and the purchaser of those vehicles from, the claimant company (Recolta) were fraudsters but there was nothing to suggest that Recolta and its directors knew or had any reason to know of the fraudulent scheme. Under Belgian law, an agreement intended to defraud a third party whose rights are protected by public policy legislation, and thus including the State, was void even if one party to the contract did not know of the

unlawful purpose. On that basis, the Belgian State argued that in both these cases repayment of input tax could be refused.

23. Since *Kittel* was the mainstay of the appellant's argument, it is necessary to quote at some length from the judgment. In answer to the questions whether in the circumstances of those two cases the payment of input tax could be denied, the ECJ first commented:

“44. The Court drew the conclusion, at paragraph 51 of *Optigen*, that transactions which are not themselves vitiated by VAT fraud constitute supplies of goods effected by a taxable person acting as such and an economic activity within the meaning of Article 2(1), Article 4 and Article 5(1) of the Sixth Directive where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge.

45. The Court observed that the right to deduct input VAT of a taxable person who carries out such transactions likewise cannot be affected by the fact that, in the chain of supply of which those transactions form part, another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing (*Optigen*, paragraph 52).

46. The same conclusion applies where such transactions, without that taxable person knowing or having any means of knowing, are carried out in connection with fraud committed by the seller.”

24. After noting that the principle of fiscal neutrality which underlies the VAT regime prevents any general distinction between lawful and unlawful transactions, the court continued:

“51. In the light of the foregoing, it is apparent that 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 their right to deduct the input VAT (see, to that effect, Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-4191, paragraph 33).

52. It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

53. By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity' are not met where tax is evaded by the taxable person himself (see Case C-255/02 *Halifax and Others* [2006] ECR I-1609, paragraph 59)."

25. The court repeated its statement in earlier cases that preventing tax evasion, avoidance and abuse is an objective encouraged by the Sixth VAT Directive and that where the right to deduct is exercised fraudulently it should be refused, and concluded:

“56. In the same way, 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 to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.

60. It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void — by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller — causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

61. By contrast, 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 taxable person entitlement to the right to deduct.”

26. Mr Patchett-Joyce stressed that the ECJ referred to the party losing the right to deduct where there is a fraud by the seller to him, which was not the case with PJJ. However, the references to fraud by the seller in *Kittel* are clearly explicable on the basis that this was the factual situation in both of the cases there under consideration: the distinction between them was that in the one, Computime was fully aware of the fraud whereas in the other, Recolta neither knew nor had any suspicion of it. Mr Patchett-Joyce relied more particularly on the French text of the judgment where the phrase “connected with fraud” and “connected with fraudulent evasion of VAT” in paras 51-52 and 56, 59-61 are expressed as “une opération impliquée dans une fraude”. It was submitted that the French text indicates a closer involvement in the fraud than the broader English expression “connected with”; and that the French text should be given priority since it is both the working language of the ECJ in which the judgment was drafted and the language of the case: see ECJ Rules of Procedure, rule 31.
27. In support of his argument, Mr Patchett-Joyce referred to the subsequent judgments of the ECJ in Case C-409/04 *Teleos* [2007] ECR I-7797, and Case C-271/06 *Netto* [2008] ECR I-771. He emphasised that three of the five judges in the Chamber which decided *Teleos* had been in the Chamber which delivered the *Kittel* judgment. In *Teleos*, the phrases “impliquée dans” and “l’implication ... dans” in the French text are translated in the English text as “involved in”: see at paras 16 and 58. It was submitted that the ECJ was thereby clarifying the translation of those words in *Kittel* and that the English rendition in the earlier judgment as “connected with” should therefore be rejected as a mistranslation.
28. I regard that submission as misconceived. Translations of ECJ judgments are the responsibility of the court translation service and the judges would not themselves

have been concerned with checking or approving the English translation of their earlier judgment in *Kittel*. However, there is some force in Mr Patchett-Joyce's argument for a different reason. In *Teleos*, the language of the case was English. Thus the English text of the judgment in *Teleos* is authentic, and as that judgment would have been drafted in French it shows that "involved in" is a correct translation of "impliqué dans", at least in the context in which the expression is used in that case.

29. In the light of that, I do not think it is necessary to consider the other case subsequent to *Kittel* relied on by Mr Patchett-Joyce, C-285/09 *Criminal proceedings against R*, judgment of 7 December 2010. There, the language of the case is German and, in any event, the phrase "il participait à une opération impliquée dans une fraude" appears only in the question referred to the ECJ by the German Federal Supreme Court and is not used in the deliberative part of the judgment at all. Moreover, that was not a case of missing trader fraud but a criminal prosecution of an actual fraudster who dishonestly concealed the identity of the foreign purchaser of goods being exported by producing false documents in the names of fictitious purchasers, and thus far removed from the issues in the present case.
30. The rendering of "impliqué dans" as "involved in" in *Teleos* indeed corresponds to the translation of "impliqué dans" as a matter of ordinary language (see, e.g., *Collins-Robert Comprehensive French Dictionary*).² And it is not unknown for the official English translation of an ECJ judgment to be incorrect: see, eg, per Fennelly AG in Cases C-395 & 396/96P *Compagnie Maritime Belge v Commission* [2000] ECR I-1365, Opinion at para 26, fn 33. However, the question is whether here this makes any substantive difference either to the underlying principle or to the application of *Kittel* to the facts of the present case. In that regard, it is clear that *Kittel* was a development of the case law following the ECJ's decision given only six-months previously in Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen & ors* [2006] ECR I-483. Four of the five judges who decided *Kittel* were also members of the Chamber which decided *Optigen* and it is clear from the judgment, as one would in any event expect, that they had *Optigen* very much in mind.
31. *Optigen* concerned three cases referred from the High Court, each concerning purchases of CPUs which the purchasing company had then exported to customers in another member State. Those transactions were found to be part of the form of MTIC fraud known as "carousel" fraud, where the final overseas purchaser was involved in the original importation into (in those cases) the UK. On that basis, the UK customs authorities refused the claims by the final exporting companies for refund of input tax. Those companies were held by the English court to be innocent parties with no knowledge of the fraud committed by others in chain. Moreover, in each case the applicant company had no direct dealings with a defaulting or fraudulent trader. The main issue in the proceedings was whether, as the customs authorities contended, the transactions did not constitute economic activities within the meaning of the Sixth Directive such that the companies were not entitled to reimbursement of the input tax which they had paid.

² I note that in *Kittel* itself the expression "impliqué dans" is elsewhere translated as "involved in": see at para 17..

32. Observing that the principle of fiscal neutrality prevents there from being any general distinction as between lawful and unlawful transactions, the ECJ held:

“51. It follows that transactions such as those at issue in the main proceedings, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge.

52. Nor can the right to deduct input VAT of a taxable person who carries out such transactions be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing.”

Accordingly, I consider that the judgment there made clear that when the trader claiming deduction of input tax was not itself fraudulent, the material consideration was whether it knew or had the means of knowing that there was another transaction in the chain characterised by fraud, irrespective of whether that fraudulent trader was one with which the taxable person dealt directly.

33. This approach is expressly referred to in the judgment in *Kittel* at paras 44-45. which form the prelude to the statement in para 46 that:

“The same conclusion applies where such transactions, without that taxable person knowing or having any means of knowing, are carried out in connection with fraud committed by the seller.”

Significantly, the French text here uses the expression “dans le cadre d’une fraude commise par le vendeur” which might also be translated as “within the scope of fraud” committed by the seller.” The subsequent references in the judgment to the taxable person taking part in “a transaction connected with fraudulent evasion of VAT” or, if that translation were substituted, “involved in fraudulent evasion of VAT” must be read in that context. In *Kittel*, the taxable person was in fact dealing directly with the fraudulent trader. Not only is there nothing in the reasoning of the ECJ in *Optigen*, as applied in *Kittel*, to suggest that the same principle does not equally apply where the taxable person is not dealing directly with a fraudulent trader, but the statement by the ECJ in *Kittel* quoted above asserts positively that the governing principle is the same. This is unsurprising: in the latter situation as much

as the former, it can fairly be said that “the taxable person aids the perpetrators of the fraud and becomes their accomplice”: see *Kittel* at para 57. I respectfully agree with Floyd J who said in *Calltel Telecom Ltd v HMRC* [2009] EWHC 1081 (Ch) at para 81:

“For my part I have no difficulty in seeing how the purchaser who is not in privity of contract with the importer aids the perpetrators of the fraud. He supplies liquidity into the supply chain, both rewarding the perpetrator of the fraud for the specific chain in question, and ensuring that the supply chains remain in place for future transactions. By being ready, despite knowledge of the evasion of VAT, to make purchases, the purchaser makes himself an accomplice in that evasion.”

34. It should be emphasised that under the principle here at issue, the question is not whether the trader himself was “involved in” or “connected with” the fraud: the starting point is that no such personal involvement is established. The defining description, “involved in” or “connected with” the fraud, is applied to his *transaction*. Hence the significance of the second part of the test which must be satisfied, which addresses the trader’s knowledge or means of knowledge. Accordingly, irrespective of whether the test should be expressed as “connected with fraudulent evasion” or “involved in the fraudulent evasion”, I consider that, if PJJ should have known that the transactions in which it was engaged were part of a chain in which one or more earlier transactions were fraudulent, albeit that its immediate supplier was not dishonest, that test is satisfied. It follows that the translation point does not make a substantive difference.
35. The analysis in the subsequent ECJ cases referred to by Mr Patchett-Joyce do not cast any doubt on that conclusion. In *Teleos*, English companies sold mobile telephones to Spanish purchasers under ex works contracts, whereby the customers were to collect the goods from bonded warehouses in the UK but the contracts specified the destination of the goods as another member State. On that basis, the English sellers were not obliged to charge VAT and they sought a refund of the input tax paid on their acquisition of the goods. However, HMRC subsequently found that the customers had produced documentation evidencing export which was fraudulent in that the telephones had never left the UK, and on that basis sought to assess the sellers to VAT on the supplies. There was no suggestion that Teleos or the other UK sellers were aware of the fraud and it was found that they had no means of establishing that fraud was involved. The judgment of the ECJ stated:

“65. Moreover, according to the Court’s settled case-law, which is applicable to the main proceedings by way of analogy, it would not be contrary to Community law to require the supplier to take every step which could reasonably be required of him to satisfy himself that the transaction which he is effecting does not result in his participation in tax evasion [citing, inter alia, *Kittel*, paragraph 51]

66 Accordingly, the fact that the supplier acted in good faith, that he took every reasonable measure in his power and that his participation in fraud is excluded are important points in deciding whether that supplier can be obliged to account for the VAT after the event.”

36. *Netto*, was a somewhat similar case, where a German supermarket chain, which had refunded to foreign customers the amounts paid for VAT on production of documents which appeared to establish that the goods had been exported, subsequently discovered that those documents were fraudulent and that no such export had taken place. The German tax authorities then assessed Netto retrospectively for VAT on those sales. The ECJ held that although the VAT regime imposes obligations on suppliers to act as tax collectors for the State and in the interests of the public exchequer, those obligations must be proportionate. After referring to paras 65-66 of the judgment in *Teleos*, the court concluded (at para 27):

“It follows that a supplier must be able to rely on the lawfulness of the transaction that he carries out without risking the loss of his right to exemption to VAT, if, as in the case in the main proceedings, he is in no position to recognise – even by exercising due commercial care – that the conditions for the exemption were in fact not met, because the export proofs provided by the purchaser had been forged.”

In *Blue Sphere Global v HMRC* [2009] EWHC 1150 (Ch), the Chancellor analysed the judgments in *Teleos* and *Netto* and noted that neither of those cases involved any form of carousel fraud (or, by implication, MTIC fraud). He held that those judgments have not as a matter of law narrowed the test set out in *Optigen* and *Kittel*: see at [25]. I respectfully agree

37. I have reached my conclusion on the basis of analysis of the ECJ jurisprudence that privity with a fraudulent trader is not a condition for refusal to credit input tax. But as a matter of English authority, the issue has been determined by the judgment of the Court of Appeal in *Mobilx Ltd v HMRC* [2010] EWCA Civ 517, [2010] STC 1436. In his judgment, with which Carnwath LJ and Sir John Chadwick agreed, Moses LJ conducted a thorough analysis of the European case law and explained that in *Optigen* the ECJ held that a fraudulent transaction does not meet the objective criteria which determine the right of the trader to deduct input tax. He observed that *Kittel* represented a development of the law by enlarging the category of those who fell outside the objective criteria “to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants”: see at [41]
38. Further, explaining the test in *Kittel*, Moses LJ stated at [59]:

“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 the *Kittel*.”

Significantly, he continued at [62]:

“The principal of legal certainty provides no warrant for restricting the connection, which must be established to a fraudulent evasion which immediately precedes a trader’s purchase. If the circumstances of that purchase are such that a person knows or should know that his purchase is or will be connected with fraudulent evasion, it cannot matter a jot that evasion precedes or follows that purchase. The trader’s knowledge brings him within the category of participant. He is a participant whatever the stage at which the evasion occurs.”

39. Although Moses LJ’s judgment does not expressly consider the argument about translation in *Kittel* that was addressed to me, he would clearly have been aware of the point since it is expressly mentioned in the judgment in *Blue Sphere Global* at [18], one of the three judgments which was under appeal before the Court of Appeal in *Mobilx*. I cannot see that it makes any difference to the analysis if the expression “involved in” were to be substituted for “connected with” in the quoted passage. Hence, the judgment of the Court of Appeal is clear authority, binding on the Upper Tribunal, that the fact that the trader claiming credit for input tax did not deal directly with a fraudulent trader but was more remote in the chain does not preclude his being denied repayment under the rationale of *Kittel*.
40. I was told that an application for permission to appeal against the judgment in *Mobilx* to the Supreme Court had been dismissed as inadmissible, and on that basis I was urged to make a reference to the ECJ of this question based on the translation point. But even if that course were open to me, given that, in my judgment, the alternative translation discussed above does not impinge in any way on the rationale and principle as explained in *Mobilx*, I would see no ground upon which a reference would be justified. I should add that the fact that there has been a subsequent reference to the ECJ made by the Bulgarian court in Case C-285/11 *Bonik*, OJ 2011 C238/08, which includes a question or questions related to this point and to which my attention was drawn subsequent to the hearing, does not alter my view.

The test applied by the FTT

41. In articulating the test to be applied at the outset of the decision, the FTT stated (at para 11):

“... while knowledge, or the means of knowledge, of some fraud connected with VAT must be established (the burden of doing so being on the Commissioners), it is not necessary to show that the trader concerned knew (or could have known) of

the details of the fraud, including the identity of the fraudster. It is enough that he knew, or had the means of knowing, or should have known, that his transaction was, on the balance of probabilities, connected with fraud.”

42. For PJJ it is submitted that this is not the correct test. It is not sufficient that the trader should have known that the transaction was on the balance of probabilities connected with fraud; the question is whether he should have known that it was connected with fraud.
43. Although it is understandable that the FTT expressed the test as it did at the time of the decision, the Court of Appeal’s judgment in *Mobilx* has established that it is insufficient to show that the trader knew or should have known that it was more likely than not that the transaction was connected with fraud: see at [53]-[60]. Accordingly, a balance of probabilities in this sense does not form part of the test and HMRC accepted on this appeal that the statement by the FTT at para 11 of the decision was incorrect.
44. If the FTT had proceeded to reach its conclusions on that basis, it would have been necessary to consider, as in *Mobilx* itself, whether on the primary facts found by the FTT the same conclusion would have been reached applying the correct test. However, on reading the decision as a whole, I am satisfied that the FTT did in fact apply a test involving the higher standard of knowledge.
45. Paragraph 11 forms part of the introductory section of the decision. As pointed out by Mr Puzey for HMRC, when the FTT came to consider its conclusions, under the heading “The legal tests” it formulated the relevant question correctly:

“whether PJJ, in the person of its controlling minds—its directors, Mr Woods and Mr Chater—entered into transactions knowing or with the means of knowing that they were connected with fraud, regardless of whether the fraud was committed by its immediate counterparty or by a trader at one or removes from it in the chain, or in another chain linked by a contra-trader”

The same formulation was repeated at paras 127 and incorporated in the summary conclusion at para 132. It is quite clear from reading the entire decision that this is the test which the FTT actually applied. Accordingly, this ground of appeal fails.

Other grounds of appeal

46. PJJ advanced no less than, in effect, seven further grounds of appeal. In the light of the judgment in *Mobilx*, those remaining grounds can be disposed of relatively shortly.
47. In para 6 of its Grounds of Appeal, PJJ points to paras 28 and 123 of the decision, and the references to HMRC’s contention that PJJ knew or should have known of fraud elsewhere in the chain on the basis that those controlling PJJ (a) were well

aware of the prevalence of fraud in the grey market trade in computer chips; (b) failed to take any proper precautions but only superficial steps designed to give the impression that care was being taken; and (c) showed a cavalier attitude to VAT compliance. Mr Patchett-Joyce criticised each of those elements individually as insufficient to establish actual or constructive knowledge of fraud.

48. However, I regard that as an over-simplification of the reasoning of the FTT in its decision. A tribunal is entitled to draw inferences from the surrounding circumstances. As Moses LJ stated in *Mobilx* at [82], after reiterating that the burden of proof rests on HMRC:

“... that is far from saying that the surrounding circumstances cannot establish sufficient knowledge to treat the trader as a participant. As I indicated in relation to the BSG appeal, Tribunals should not unduly focus on the question whether a trader has acted with due diligence. Even if a trader has asked appropriate questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for them is that his transactions have been or will be connected to fraud. The danger in focussing on the question of due diligence is that it may deflect a Tribunal from asking the essential question posed in *Kittel*, namely, whether the trader should have known that by his purchase he was taking part in a transaction connected with fraudulent evasion of VAT. The circumstances may well establish that he was.”

See also the statement of Moses LJ at [59] quoted in para 39 above.

49. Here, it is clear from its decision that the FTT conducted a careful examination of the surrounding circumstances. I have referred at paras 15 to 17 above to some of the key factual findings which it made. It was also clearly relevant, as one of the surrounding circumstances and as regards the credibility of PJJ’s witnesses, that the same company run by the same individuals engaged in other sham transactions designed only to generate tax liabilities and about which Mr Chater or Mr Woods gave inadequate or evasive explanations, albeit that those transactions were distinct from the transactions to which these decisions on input tax related. The FTT’s final conclusion regarding PJJ’s actual or constructive knowledge was based on the cumulative effect of all its findings. The three factors referred to in para 28 were therefore considered not in isolation but in combination, and once the details of the FTT’s findings are considered, I see no basis for criticism of its approach: those findings justified the overall conclusion which it reached.
50. Next, at paras 7 and 9 of its Grounds of Appeal, PJJ submitted that the FTT wrongly sought to determine whether the transactions to which PJJ was a party were lawful or not, contrary to the principle of fiscal neutrality. This challenge is based on para 66 of the decision and the statement that “the transactions are not of a kind one might expect in a legitimate market.” However, it is clear on any fair reading of the decision

that this statement comes within a discussion of these chains of transactions and whether their nature indicated that this was a contrived and artificial market. That has nothing to do with seeking to determine whether an individual transaction was lawful so as to come within the VAT system. As Mr Puzey pointed out in his skeleton argument, at no point did the FTT purport to distinguish between transactions that were within the VAT system and those that were not as justification for the decision to deny input tax. There is nothing in this point.

51. Para 8 of the Grounds of Appeal concerns the three contra-trading transactions. It had not been alleged by HMRC that PJJ actually knew that the transactions which it entered into formed part of a contra-trading chain, and PJJ contended that no tribunal, properly directing itself, could have reached the conclusion that PJJ should have known that the contra-trade chains were being used for fraudulent evasion of VAT. PJJ particularly relied on the fact that the transactions in which the fraudulent contra-traders were engaged were only set off in their VAT returns submitted after the end of July 2006.
52. However, I do not see that there is any requirement that PJJ should reasonably have known the identity of the contra-trader. HMRC must establish that fraudulent evasion of VAT took place, and if the form of fraud involved was contra-trading then that is what they have to prove. But it is a misconception to consider that they must also establish that the party seeking to deduct input tax (i.e., here, PJJ) should reasonably have known that its own transaction was connected to (or involved in) this particular form of missing trader fraud as opposed to another form. I do not regard the Chancellor's judgment in *Blue Sphere Global* as authority to the contrary. Moreover, I respectfully agree with the approach expressed by Briggs J in his subsequent judgment in *Megtian Ltd v Commissioners* [2010] EWHC 18 (Ch), at [37]-[38]:

“... there are likely to be many cases in which a participant in a sophisticated fraud is shown to have actual or blind-eye knowledge that the transaction in which he is participating is connected with that fraud, without knowing, for example, whether his chain is a clean or dirty chain, whether contra-trading is necessarily involved at all, or whether the fraud has at its heart merely a dishonest intention to abscond without paying tax, or that intention plus one or more multifarious means of achieving a cover-up while the absconding takes place.

Similarly, I consider that there are likely to be many cases in which facts about the transaction known to the broker are sufficient to enable it to be said that the broker ought to have known that his transaction was connected with a tax fraud, without it having to be, or even being possible for it to be, demonstrated precisely which aspects of a sophisticated multifaceted fraud he would have discovered, had he made reasonable inquiries. In my judgment, sophisticated frauds in the real world are not invariably susceptible, as a matter of law, to being carved up into self-contained boxes even though, on

the facts of particular cases, including *Livewire*, that may be an appropriate basis for analysis.”

53. In any event, it is clear from the Court of Appeal judgment in *Mobilx*, where one of the three cases under appeal was *Blue Sphere Global*, that no special approach is required in a case involving contra-trading. The correct test as regards knowledge is always the same. It is the test derived from *Kittel* as set out in para [59] of Moses LJ’s judgment: see para 39 above. Hence, in the section of his judgment that addressed the specific appeal in *Blue Sphere Global*, Moses LJ found that although the case on the facts came close to satisfying the test, the tribunal had focused unduly on whether Mr Peters, the company’s sole shareholder and director, had exercised sufficient care and diligence, and what he might have found out if he had made further inquiries, and thus had failed to make a finding applying the correct test. Moses LJ concluded at [75]:

“The ultimate question is not whether the trader exercised due diligence but rather whether he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT. The Tribunal might have concluded that Mr Peters should have known that the transactions into which he entered were connected with fraud, by reference to the unconventional nature of those circumstances (a finding it came close to making at para 228). But it was not the only decision within the bounds of reasonable conclusion.”

54. By contrast with the tribunal in *Blue Sphere Global*, the FTT here emphasised that the test was “not whether PJJ took adequate precautions, but whether it knew or had the means of knowing that its transactions were connected with fraud”: para 127. Based on a thorough consideration of all the surrounding circumstances, it found that PJJ knew or must have known that it was engaged in an artificial, contrived market, and that finding applies to the three transactions that were part of a contra-trading chain as much as to all the others. This ground of appeal is accordingly misconceived.
55. Para 10 of the Grounds of Appeal takes issue with the FTT’s reference in para 92 to the need on the part of PJJ to ensure that “the transactions themselves” were untainted. I think it is clear that this is a reference to the transactions which PJJ entered into. On that basis, this ground effectively duplicates the ground in paras 7 and 9 of the Grounds of Appeal: “untainted” was a reference not to the transaction being unlawful but to whether there were features about the transaction which showed that it was not part of normal trading on a genuine market.
56. Para 11 of the Grounds of Appeal challenges a factual finding by the FTT as regards PJJ’s subsequent dealing in set-top boxes on *Edwards v Bairstow* grounds, i.e. as a finding that no tribunal could properly reach.
57. In that regard, it is important to note the specific finding that is challenged and its context. At paras 107-111, the FTT analysed the dealing by PJJ in set-top boxes in

the three months following the VAT return at issue. A company in the same group as P JL, Granville Technology Group Ltd (“GTG”), owned a large number of television set-top boxes when it went into administration in July 2005. The FTT found that although those boxes had negligible value, they were acquired by P JL, without the administrator’s knowledge, from another group company registered in Dubai at a unit price of £49 (purchases for which it claimed to deduct the input tax) and resold for £50 to another group company, which resold them to yet another group company based in Dubai. They were then shipped to a company in Hong Kong that was 50% owned by Mr Chater, supposedly for technical adaptation there so that they could be sold to India. The FTT found that the evidence (from Mr Chater and Mr Woods) that the set-top boxes had a market in India was incredible, and that the boxes were worth as much as £50 as “pure invention”, and held that this chain of transactions was “an artificial device arranged for no purpose other than to secure repayment, by illegitimate means, of the input tax for which credit had been claimed”: para 113.

58. None of the above is challenged by P JL on this appeal as findings which the FTT could not properly reach. None of this relates to the trading by P JL in computer chips that is the subject of the disallowed claims. The relevance attributed by the FTT to these dealings in set-boxes was as a clear demonstration that those controlling P JL “cannot be regarded as straightforward businessmen doing their best in a difficult market”: para 131. All that is now challenged is the FTT’s statement, to which I have not referred in the above summary, that the boxes had been “effectively stolen” from GTG: para 111. In fact, the way the boxes came into the control of the Dubai group company which sold them to P JL, when the FTT found that the administrator of GTG (who gave evidence at the hearing) had not abandoned them, was obscure. It may be that in expressing it in this way the FTT was putting it too high. But irrespective of whether it was right to consider that the boxes were stolen from GTG, there was more than sufficient basis in the other aspects of these dealings in the set-top boxes to justify the overall finding regarding the character of those controlling P JL, and as supporting material towards the FTT’s assessment of the credibility of Mr Chater and Mr Woods. Accordingly, this ground of appeal does not even begin to provide a basis for setting aside the FTT’s decision.
59. In para 12 of its Grounds of Appeal, P JL challenges the decision as discriminatory and disproportionate, and thus contrary to fundamental principles of EU law. As to proportionality, since the test applied to establish the right to refuse deduction is that formulated by the ECJ in *Optigen* and *Kittel*, to accept this submission would amount to finding that the ECJ itself failed to have regard to that principle. That would be a remarkable conclusion and, unsurprisingly, it was rejected as unarguable in *Moblix*: see at [66].
60. As to non-discrimination, this appeal concerns the decision by HMRC that the objective criteria determining the right to deduct input tax were not met as regards these claims for repayment by P JL. If that is the case, P JL were not entitled to such repayments, irrespective of the position of anyone else. The FTT’s dismissal of this argument was therefore entirely correct: see at para 120. Furthermore, whether or not HMRC could have applied a similar approach to the traders who served as buffers in the chains (who would generally not be making a repayment claim to HMRC but

simply crediting the input tax against the output tax received) does not affect that conclusion; and whether HMRC should have pursued those traders for an account of the output tax received is a question of policy regarding the effective enforcement of the VAT regime, with no doubt limited resources. Accordingly, I consider that the principle of non-discrimination is not engaged.

61. Finally, para 13 of the Grounds of Appeal appears to challenge the FTT's reliance, as relevant to its decision, on its finding that the supposed due diligence undertaken by PJJ was superficial and intended purely to give HMRC the impression that precautions were being undertaken. However, the FTT relied on its analysis of PJJ's evidence of supposed due diligence both in its adverse findings as to the credibility of PJJ's two witnesses, which was relevant to all their evidence, and as supporting its conclusion that PJJ knew that it was engaged in an artificial, contrived market, which was clearly relevant in applying the *Kittel* test. There was no error by the FTT in either respect.

Conclusion

62. The FTT's decision is a commendably thorough and closely reasoned analysis, following the receipt of a substantial volume of evidence. For the reasons set out above, all the grounds of appeal are to be rejected, and this appeal is dismissed.

Tribunal Judge:

Mr Justice Roth

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