[2015] UKUT 0419 (TCC)

Appeal number: UT/2014/0008

VALUE ADDED TAX - Missing Trader Intra-Community Fraud – whether taxable person should have known that its transactions were connected to fraud – whether deliberate failure to ask questions where taxable person aware of risk of fraud satisfies should have known test – Axel Kittel v Belgian State and Mobilx v HMRC considered - appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

WIRELESS WIZARDS LIMITED

Appellant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: The Hon Mr Justice Newey
Judge Greg Sinfield

Sitting in public in London on 20 and 21 July 2015

Liban Ahmed of Controlled Tax Management Limited for the Appellant

Paul O'Doherty, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by Wireless Wizards Limited ('WW'). It concerns a missing trader intra-Community ('MTIC') fraud. A brief description of the type of MTIC fraud that occurred in this case was given by Lewison J in *HMRC v Livewire Telecom Ltd* [2009] EWHC 15 (Ch), [2009] STC 643 ('*Livewire*') at [1] as follows:

> "A trader … imports goods from another Member State. No VAT is payable on the import. Typically the goods are high value low volume goods, such as computer chips or mobile phones. He then sells on those goods to a domestic buyer and charges VAT. He dishonestly fails to account for the VAT to HMRC and disappears. The domestic buyer sells on to an exporter at a price which includes VAT. The exporter exports the goods to another Member State. The export is zero-rated. So the exporter is, in theory, entitled to deduct the VAT that he paid from what would otherwise be his liability to account to HMRC for VAT on his turnover. If he has no output tax to offset against his entitlement to deduct, he is, in theory, entitled to a payment from HMRC. Thus HMRC directly parts with money. Sometimes the exported goods are re-imported and the process begins again. In this variant the fraud is known as a carousel fraud. There may be many intermediaries between the original importer and the ultimate exporter. These intermediaries are known as 'buffers'. The ultimate exporter is labelled a 'broker'. A chain of transactions in which one or more of the transactions is dishonest has conveniently been labelled a 'dirty chain'. Where HMRC investigate and find a dirty chain they refuse to repay the amount reclaimed by the ultimate exporter."

2. WW traded in mobile phones. In April 2006, WW purchased four lots of mobile phones from The Accessory People Global Limited ('TAP'). WW paid TAP £5,941,750 plus VAT, ie a total of £6,981,806.25 including VAT, for the phones. As WW knew, the phones had been imported into the UK from France. In each case, WW sold the phones, on the same day that it purchased them, to World Communications, which was a customer of TAP based in Spain, to be delivered in France, where TAP also had a French operation, for a total of £6,176,500. As the sales were zero-rated supplies, WW did not charge any output VAT. In its VAT return for the quarterly accounting period 04/06, WW claimed input tax of £1,039,806.25 on the four purchases of mobile phones from TAP and claimed a total repayment of £1,042,075.88.

3. The Respondents ('HMRC') refused WW's claim in a letter dated 18 April 2008 on the grounds that the transactions were part of an MTIC fraud. HMRC considered that WW, through its sole director Mr Vernon Hall, knew or ought to have known that the transactions were connected with the fraudulent evasion of VAT and, therefore, WW was not entitled to deduct input tax incurred on the purchase of the mobile phones.

4. WW appealed to the First-tier Tribunal ('FTT'). The appeal was heard over three days in July 2013. WW accepted that the transactions were connected to tax losses that had arisen as a consequence of an orchestrated fraud involving TAP and World Communications. The only issue for the FTT was whether WW, through Mr Hall, knew or should have known that the sales of mobile phones which it carried out as part of these four deals were connected with fraud.

5. In a decision released on 22 November 2013, [2013] UKFTT 680 (TC), ('the Decision'), the FTT (Judge Short and Ms G Hunter) found that Mr Hall knew that the deals were too good to be true but concluded that the evidence did not establish, on the balance of probabilities, that he, and through him WW, had actual knowledge that the deals were fraudulent. The FTT held that that, by intentionally failing to ask questions that would have shown that these deals were connected with fraud, Mr Hall suspected and WW should have known that these deals were connected with fraud. Save as otherwise indicated, paragraph references in square brackets in this decision are to the paragraphs in the Decision.

6. WW now appeals, with the permission of the FTT, against the Decision on the single ground that the FTT failed to apply the correct test for determining whether WW should have known that the transactions were connected to fraud. There is no appeal by HMRC against the FTT's finding that WW did not have actual knowledge of the connection to fraud. For the reasons set out below, we have decided that the FTT identified the correct test and applied it correctly in finding that WW should have known that its transactions were connected to fraud. Accordingly, WW's appeal is dismissed.

Law

7. The Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of Member States relating to turnover taxes - common system of value added tax: uniform basis of assessment, ('the Sixth VAT Directive'), was the Directive in force at the time of the transactions that are the subject of this appeal. Article 17 of the Sixth VAT Directive provided that a taxable person has a right to deduct VAT which the taxable person has paid or is liable to pay in respect of goods and services supplied to the taxable person to the extent that the goods and services are used for the purposes of the taxable person's taxable transactions (ie supplies of goods and services other than exempt supplies) or transactions treated as such carried out in the course of an economic activity.

8. The Court of Justice of the European Communities ('the ECJ') has determined that there is an exception to the right to deduct. In Joined Cases C-439/04 and C-440/04 *Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL* [2006] ECR I-6161, [2008] STC 1537 ('*Kittel*'), the ECJ held that a taxable person who knew or should have known that, in purchasing goods, he was taking part in a transaction connected with the fraudulent evasion of VAT, loses the right to deduct input tax on those goods.

9. In *Kittel*, the ECJ stated at [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 their right to deduct the input VAT …"

10. At [56] – [59] of *Kittel*, the ECJ concluded as follows:

> "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.
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> 57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
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> 58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.
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> 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'."

11. In *Mobilx Limited and others v HMRC* [2010] EWCA Civ 517, [2010] STC 1436 ('*Mobilx*') the Court of Appeal considered the meaning of "should have known" in *Kittel*. Moses LJ, with whom Carnwath LJ and Sir John Chadwick agreed, held at [51] and [52];

> "51. Once it is appreciated how closely *Kittel* follows the approach the court had taken six months before in [C-354/03 *Optigen Limited v Customs and Excise* [2006] ECR I-483], it is not difficult to understand what it meant when it said that a taxable person 'knew or should have known' that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT. In *Optigen* the court ruled that despite the fact that another prior or subsequent transaction was vitiated by VAT fraud in the chain of supply, of which the impugned transaction formed part, the objective criteria, which determined the scope of VAT and of the right to deduct, were met. But they limited that principle to circumstances where the taxable person had 'no knowledge and no means of knowledge' (§ 55). The court must have intended *Kittel* to be a development of the principle in *Optigen*. *Kittel* is the obverse of *Optigen*. The court must have intended the phrase 'knew or should have known' which it employs in §§ 59 and 61 in *Kittel* to have the same meaning as the phrase 'knowing or having any means of knowing' which it used in *Optigen* (§ 55).
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> 52. If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with the fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. … A trader who fails to deploy the means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

12. Moses LJ considered the extent of knowledge that was required at [53] – [60]. He rejected HMRC's argument that, in order for the right to deduct to be denied, it was sufficient to show that the trader knew or should have known that it was more likely than not that transactions were connected to fraud at [56]:

> "56. It must be remembered that the approach of the court in *Kittel* was to enlarge the category of participants. A trader who should have known that he was running the risk that by his purchase he *might* be taking part

> in a transaction connected with fraudulent evasion of VAT, cannot be regarded as a participant in that fraud. The highest it could be put is that he was running the risk that he might be a participant. That is not the approach of the court in *Kittel*, nor is it the language it used. In those circumstances, I am of the view that it must be established that the trader knew or should have known that by his purchase he was taking part in such a transaction, as Sir Andrew Morritt C concluded in his judgment in [*HMRC v Blue Sphere Global Limited* (*'BSG')*] (at (§ 52):-
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> > '… The relevant knowledge is that BSG ought to have known by its purchases it was participating in transactions which were connected with a fraudulent evasion of VAT; that such transactions might be so connected is not enough.'"

13. What Moses LJ meant by "should have known" can be seen from his description of HMRC's objections, which were not accepted, at [57]:

> "HMRC object that the principle should not be restricted to those cases where a trader has deliberately refrained from asking questions lest his suspicions should be confirmed. This has been described as a category of case which is so close to actual knowledge that the person is treated as having received the information which he deliberately sought to avoid …"

14. Moses LJ summarised his conclusions at [59] and [60]:

> "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*.
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> 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."

15. Moses LJ went on to consider how the *Kittel* principle, as he had explained it, was to be applied in the case of BSG. BSG concerned a contra-trading MTIC fraud in which there are two chains, a clean and a dirty chain. The effect of the clean chain is to distance the defaulter from the person making the repayment claim thereby making it harder for HMRC to detect the fraud. BSG was at the end of the clean chain. In *BSG*, the FTT concluded in [228] that:

> "We think that if [Mr Peters, the sole director of BSG] had asked and obtained answers to the appropriate questions, he [Mr Peters] would have concluded that the uncommercial features of the deal being offered to BSG could only be explained by taking into account other transactions which Infinity was entering into, and that the most probable explanation

> was that those other transactions were connected in some way with fraud."

16. On appeal, the High Court found that the FTT's findings were insufficient to establish that BSG ought to have known that by its past purchases it *was* participating in transactions which were connected with fraudulent evasion of VAT.

17. Moses LJ was not prepared to disturb the High Court's conclusion because, as he put it in [74] and [75]:

> "74. Read as a whole, the tribunal does not appear to have found that BSG should have concluded that the only reasonable explanation for the circumstances in which it entered into the impugned transactions was that those transactions were connected with fraud. But the tribunal came very close to making such a finding and I have only stepped back from reaching that conclusion myself because of the tribunal's references to risk (§§ 162 and 226) and in particular because of the tribunal's undue focus on whether Mr Peters had exercised due diligence or done 'enough to protect himself'. That is not the only question.
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> 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."

Background

18. The FTT set out the background to WW and the four deals at [9] - [14], the evidence at [15] - [19] and their findings of fact at [20] - [52]. There is no challenge of the type described by the House of Lords in *Edwards v Bairstow* [1956] AC 14 to the findings of fact by the FTT. For the purposes of this appeal, the relevant findings of fact can be summarised as follows.

19. Mr Hall had been involved the retail sale of mobile phones since 1989. In 1997, Mr Hall was involved in a mobile phone business with Mr Andrew Nicolas and his brother through an entity known as Xcell Communications. Mr Hall was a witness at the trial of Mr Nicolas and an entity called Ellagold for money laundering offences connected with MTIC fraud that were committed in August 1998 after Mr Hall had ceased to have any connection with them. Mr Nicolas and Ellagold were convicted.

20. Between 1998 and 2003, Mr Hall owned a company called Worldwide Communications UK that traded in the wholesale mobile phone industry.

21. In August 2005, Mr Hall made contact with TAP. Mr Hall told the FTT that no one specifically introduced him to TAP but that he had always been aware of it as a large player in the industry.

22. WW, which had been incorporated and registered for VAT in 2002, was acquired by Mr Hall on 20 September 2005. Mr Hall was unable to say how he had purchased WW. It was clear, however, that he had done so with a view to entering into transactions with TAP. Mr Hall was the sole director. WW's business was stated to be "wholesale trading of mobile telephones, computer components and other electrical goods". When Mr Hall acquired WW, it already had an existing bank account with First Curacao International Bank ('FCIB'). Mr Hall told the FTT that he knew nothing

about FCIB at that time but he did not think that there was anything odd in WW having an offshore bank account and he used it.

23. Mr Hall attended a meeting with Steve Isles, the managing director of the TAP Group, and Chris Frazer, the sales manager, at TAP's offices on 26 September 2005. The FTT accepted that TAP appeared to operate a successful business from impressive offices, with numerous signs of their success displayed, from the award photographs in the offices to the sports cars parked in the parking bays. At the meeting, TAP explained its trading model and that it needed to release funds because its large VAT repayments were not being processed quickly enough by HMRC. Mr Hall understood from those discussions that a company like WW could solve TAP's cash flow problems by replacing TAP as the entity claiming repayments of VAT on supplies made to TAP's EU clients. Mr Hall told the FTT that he asked specifically about the risk of fraud in dealing with TAP and was assured by TAP that it was the importer of the goods and knew where the goods came from. Mr Hall said that he was aware that TAP had its own legal and compliance departments which carried out checks on WW and Mr Hall himself.

24. On 19 October 2005, Mr Hall borrowed £400,000 for twelve months at an interest rate of 15% from a friend, Mr Langley, to finance WW's activities. The loan was backed by a personal guarantee from Mr Hall. WW commenced trading with TAP at the end of October 2005.

25. Mr Hall was aware of the risks of VAT fraud in the mobile phone industry and had seen HMRC's notice 726 "Joint and Several Liability", although he was not certain that he would have been aware of the contents of the notice in November 2005. Mr Hall told the FTT that he saw TAP as a defence against the risk of being caught in an MTIC fraud because TAP had confirmed that they were the importer.

26. On 11 April 2006, HMRC authorised a repayment of £482,000 VAT claimed by WW in relation to earlier transactions between WW and TAP. HMRC paid the VAT to WW on 24 April 2006. Mr Hall told the FTT that he regarded the repayment as a stamp of approval from HMRC that it was safe to trade with TAP.

27. In April 2006, WW entered into the following further transactions.

(1) On 24 April 2006, WW bought 10,000 Nokia 6680 from TAP at £188.50 each plus VAT, ie £1,885,000 plus VAT of £329,875 being £2,214,875 in total. On the same day, WW sold the phones to World Communications for £196 each without VAT, ie £1,960,000. World Communications paid WW for the phones on 15 June in two tranches of £921,200 and £1,038,800. Six minutes after receipt of payment from World Communications at 23.18 pm, WW paid £1,040,99.25 to TAP in respect of the purchase of the phones.

(2) On 24 April 2006, WW bought 1,500 Samsung D600 from TAP Global for £169.50 each plus VAT, ie £254,500 plus VAT of £44,493.75 being £298,993.75 in total. On the same day, WW sold the phones to World Communications for £176 each without VAT, ie £264,000. World Communications paid WW £264,000 for the phones on 21 June.

(3) On 28 April 2006, WW bought 5,000 Nokia 8800 from TAP Global for £416 each plus VAT, ie £2,080,000 plus VAT of £364,000 being £2,444,000 in

total. On the same day, WW sold the phones to World Communications for £432.50 each without VAT, ie £2,162,500. World Communications paid WW for the phones in two tranches of £1,195,600 on 29 May and £966,900 on 14 June. On the same days as it was paid by World Communications, WW made two payments of £1,350,000 each to TAP.

(4) On 28 April 2006, WW bought 5,000 Nokia 9300i from TAP Global for £344.50 each plus VAT, ie £1,722,500 plus VAT of £301,437.50 being £2,023,937.50 in total. On the same day, WW sold the phones to World Communications for £358 each without VAT, ie £1,790,000. World Communications paid WW for the phones in two tranches of £1,324,600 on 15 May and £465,400 on 21 June.

28. The total value of all of these deals was £5,941,750 excluding VAT. In each deal the entity which WW acquired its phones from was TAP and the entity which WW sold its phones to was World Communications. WW did not pay TAP for the phones but paid another TAP group entity, TAP Limited.

29. WW did not produce any detailed contractual terms for the four deals with TAP and World Communications. In relation to each deal, there was a letter from TAP to WW headed "Brokerage export deal" appointing WW as broker and stating that the goods had been imported, VAT had been declared on them and the CMR documentation was pending. Mr Hall told the FTT that he could not recall seeing the actual CMRs and his view was that TAP's letters were deliberately intended to mislead WW into believing that CMR documentation existed when, in fact, it did not.

30. The letter from TAP also set out the basis of WW's remuneration for acting as broker which was the difference between the price at which WW bought the phones from TAP and the price at which it sold them to World Communications. In fact, TAP controlled WW's remuneration in that it knew the price at which it sold the phones to WW and it stipulated the maximum price at which WW should sell the phones to World Communications. In each of the four deals, WW achieved a profit margin of either 3.8% or 3.9%. Mr Hall could not explain why the margins were so consistent on each deal. When asked what he was required to do in order to earn these margins, the FTT found that his answers were not very specific. Mr Hall referred to the administration and the need to deal with World Communications and freight forwarders and said that he was being utilised for his knowledge of the mobile phone market.

31. In respect of each deal, TAP provided WW with a signed pro forma document that stated that TAP was trading under HMRC guidelines, that VAT on the sale would be declared to HMRC and that the stock existed and was of legitimate quality.

32. The FTT was not shown any documentation in respect of WW's introduction to World Communications and considered that it was unclear what, if anything, Mr Hall knew about World Communications before April 2006.

33. Mr Hall could not recall who he dealt with at World Communications. He said that the negotiations were mainly done by telephone and he could not recall the details of them. Mr Hall told the FTT that he could not recall any details of the terms of the contracts for the transactions.

34. In relation to the first deal, Mr Hall could not recall when payment should have been made. Mr Hall said that he understood that the phones would only be released when WW received payment in full from World Communications. In fact, the FCIB bank account evidence showed that payment was made by World Communications to WW on 15 June 2006 after the goods were released on 24 April. When asked about this, Mr Hall said it was a long time ago and he could not remember all the details.

35. In relation to the second deal, Mr Hall could not say when the phones were shipped or when they were released to World Communications and he could not say when WW was paid by World Communications. In fact, invoices were issued and the release notification was signed on 24 April 2006 but full payment was not made until 21 June.

36. In relation to the third deal, the FTT found that the goods appeared to have been released on 28 April and shipped on 4 May. World Communications paid WW and WW paid TAP for the phones in two tranches. on 29 May and 14 June, totalling £2,162,500. On the same days, WW paid TAP a total of £2,700,000 ie £256,000 more than the price agreed with TAP. TAP immediately repaid the overpayment.

37. In relation to the fourth deal, which followed a similar pattern, a fax relating to the release of the goods was dated 28 April 2006 but World Communications paid WW in two tranches, namely £1,324,600 on 15 May and £465,400 on 21 June.

38. Mr Hall told the FTT that he did not offer credit to World Communications but he could not explain how this could be correct when payment was made on deferred terms in all four deals. Mr Hall told the FTT that he had not checked the creditworthiness of World Communications because it was not required. He said that if World Communications failed to pay then it would be TAP's problem not WW's.

39. Mr Hall said that he knew little about the freight forwarders who were involved in each of these deals. He told the FTT that this was his first experience of using a freight forwarder and he did not check their premises or their reputation although they held the phones that were the subject of each deal. He said that he relied on TAP's knowledge of the freight companies. Mr Hall could not explain what 'ship on hold' or 'release' in the instructions to the freight forwarders meant or what it was that triggered the release of the goods from WW's ownership. Mr Hall told the FTT that he was relaxed about the deals because World Communications was TAP's customer. Mr Hall said that, although WW had organised the shipping of the phones to the EU in the first deal, he could not recall faxing a copy of the CMR documentation nor did he know where it was kept. The only CMR documentation which was produced to the FTT related to the fourth deal.

40. WW did not have any insurance in relation to the phones while they were in its ownership. Mr Hall told the FTT that WW relied on TAP and its own insurance to make good any losses in respect of the phones while they were transferring from WW to World Communications. Mr Hall could not recall having reviewed a copy of TAP's insurance documents in relation to the phones in the four deals and was not aware of the precise terms of any insurance policy. Mr Hall agreed that he should have reviewed the terms of the insurance, particularly as WW shipped the phones 'CIF' (cost insurance and freight).

41. As to verifying the phones that were the subject of each deal, Mr Hall said that he had checked some of the IMEI (International Mobile Equipment Identification) numbers of the phones that he purchased but could not be precise about when this was actually done. Mr Hall told the FTT that he expected the freight forwarders to inspect the goods on his behalf and he assumed that this would be done. He was unclear about the circumstances in which WW would actually inspect the goods themselves. In relation to the first deal, Mr Hall could not recall when inspection had taken place. Mr Hall said that he was aware that he had the right to inspect the phones while they were in the warehouse and he thought that he had undertaken "quite a few" inspections but he could not recall the precise dates. The FTT saw some documentary evidence that the phones had been inspected while held by the freight forwarders in the UK but it was not clear on whose behalf these inspections had been made.

42. Mr Hall was very unclear about when ownership of the phones transferred in the four deals. Mr Hall told the FTT that he relied on TAP's instructions to ensure that the goods were released and payments made.

The Decision

43. As recorded by the FTT in [3] and [4], WW accepted that the four deals that were the subject of the appeal were part of an orchestrated fraud involving TAP and its customer, World Communications, in Spain that resulted in tax losses of £968,000. The FTT quoted the relevant passages from *Kittel* and *Mobilx* at [6] and [7] and referred to recent decisions of the FTT that considered the 'should have known' test at [8]. The FTT set out the parties' submissions on whether WW knew or should have known that the transactions were connected to fraud at [53] - [59].

44. The FTT began the discussion of the case by setting out the test to be applied at [60] - [62]:

> "60. There is no doubt that there are many aspects of these deals which would make a normal business person suspicious. Mr Hall's lack of knowledge of, or ability to remember, what might be considered to be the fundamental elements of transactions which were, in the light of WW's pre-existing business, extremely significant, is surprising to say the least. These were clearly not normal business transactions either for the mobile phone, or any other type of UK business. However, in order to deny WW's right to have its VAT re-paid, HMRC have to demonstrate more than that these were contrived, non-commercial transactions.
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> 61. It is clear that the onus of proof is on HMRC to establish the basis on which the right to a reclaim for input tax can be denied. HMRC have to demonstrate on the basis of the civil standard of proof (more likely than not) that WW 'knew, or should have known that by these particular purchases WW was taking part in a transaction connected with fraud'. This is a relatively high standard, …, the test is not that WW knew or should have known that the deals were likely to have been fraudulent, or that there was a risk they might have been fraudulent, but that WW knew or should have known that each of the supplies in Deals 1 – 4 were connected with fraud.
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> 62. The test is to be applied by reference to a reasonable person in Mr Hall's and WW's position, knowing what Mr Hall (and WW) knew or should have known. The Appellant has argued that the test is whether

> WW 'knew for sure' it was dealing with fraudulent transactions. The Tribunal considers that the test is not quite that stringent. The test is whether taking all the circumstances of the deals as known to WW, it was clear that the deals were fraudulent or, in the alternative, that the only reasonable explanation for those deals was that they were fraudulent. In applying this test it is necessary to strip away the hindsight which we now have of what the deals actually involved and apply the test by reference to what was known to WW at the time, in summer 2006 when these deals were done."

45. The FTT then addressed the issue of whether Mr Hall and WW actually knew that the transactions were connected to fraud and made certain findings of fact at [64] - [74]. The FTT considered that Mr Hall was not a particularly credible witness in relation to these deals and he gave an impression of evasiveness. They noted that Mr Hall's evidence was vague in a number of places. He could not recall some basic facts about the deals and had difficulty recalling the precise details of many aspects of the transactions. The FTT, at [64], observed that

> "Mr Hall's main response to questions about what he knew [was] his lack of detailed memory and knowledge. Mr Hall was not a very satisfactory witness in that regard and we have drawn our own conclusions as much from what Mr Hall could not tell us, as from the limited amount of information which he was willing to provide."

46. The FTT found that WW knew that mobile phones made outside the UK were being imported by TAP into the UK from France and then re-exported from the UK to a warehouse in France where TAP already had an operation. WW also knew that it was making a standard profit margin of just under 4% on every deal in return for doing very little. The FTT also found that Mr Hall knew that fraud was prevalent in the mobile phone market.

47. The FTT concluded, at [67], that Mr Hall and WW did not know:

(1) the details of the deal chains above TAP;

(2) that, contrary to TAP's assurances, there was no valid CMR documentation;

(3) the payments made through the FCIB accounts were circular;

(4) anything about the condition of the mobile phones.

The FTT considered that WW could have obtained further relevant information about these matters but chose not to enquire.

48. The FTT also found that there were a number of significant commercial issues, which were fundamental to the transactions, that WW either did not know or did not understand. The FTT found that that WW did not insure the phones for the period that it owned them but assumed, without checking, that it was covered by TAP's insurance; it had lacked knowledge about the freight carriers, who shipped the phones, and the creditworthiness of World Communications, who bought them; and it had no or little understanding of the terms on which the phones were sold. The FTT accepted that WW did not know anything about the transactions prior to its purchase from TAP or the circularity of payments.

49. The FTT set out their conclusions on actual knowledge at [71] – [74]. At [71], the FTT concluded that:

> "… Mr Hall knew that these deals were too good to be true, but on the basis of the evidence provided [we] do not consider that this is sufficient to demonstrate that Mr Hall had actual knowledge that the deals were fraudulent."

50. The FTT considered the significance of the contrived nature of the transactions in [73]:

> "… while the contrived elements of the transactions certainly appear suspicious, we do not consider that this is enough in itself to establish that fraud must be the explanation. While contrivance might often be present in fraudulent deals, that does not mean that contrivance indicates the necessary existence of fraud."

51. In [74], the FTT concluded that HMRC had not proved, on the balance of probabilities, that WW had actual knowledge that the deals were connected to fraud. In this appeal, we have not been asked to re-make the decision of the FTT on this issue (see the comments of Lord Carnwath in *Pendragon Plc v HMRC* [2015] UKSC 37 at [50] on when it may be appropriate for the Upper Tribunal to do so) and we consider that we should not do so.

52. The FTT's discussion and conclusion on whether WW should have known of the connection to fraud are at [75] - [80] and [82] - [87]. The FTT set out the test that they had to apply at [75]:

> "75. It would be easy to establish that WW should have suspected that fraud was present here, but that is not the test which we are asked to apply. We are asked whether WW should have known that fraud was present."

53. At [77], the FTT acknowledged that TAP was a powerful and credible company but then went on to identify, in [78], a number of circumstances that Mr Hall and WW were aware of and that should have aroused their suspicions. The suspicious circumstances included the fact that WW was given the opportunity to make a large profit for no risk, there was always a willing buyer at a more or less set price and the deals were all carried out within a very short time frame.

54. Mr Liban Ahmed, who appeared for WW, submitted that [79] contained numerous inconsistencies of logic and so we set it out in full:

> "In any other market, this [ie the suspicious circumstances] might have aroused suspicions, in this particular market, it definitely should have. We agree with HMRC that the hallmarks of MTIC trades are clearly visible and would have been visible to Mr Hall. Given Mr Hall's experience of this market, this should have put him on notice that there was a significant risk of fraud. On the basis of the *Mobilx* decision, in cases like this the Tribunal should look at totality of evidence. On the basis of Mr Hall's evidence, or in many cases, lack of ability to provide any evidence, the Tribunal's view is that WW intentionally failed to [ask] questions which might have made it aware of fraud. We think that this puts them in the same category as taxpayers who intentionally ignore the existence of fraud. To use the terminology applied in another similar

> decision, Mr Hall and WW had at least 'blind eye knowledge' that fraud was the only reasonable explanation for these deals."

55. In [80], the FTT set out three questions that they considered WW could have asked and the answers to which would have confirmed that the transactions were connected to fraud. The questions formed an important part of WW's grounds of appeal and they are set out at [59] below.

56. At [82], the FTT stated their conclusion:

> "82. Nevertheless we have concluded that Mr Hall's absence of knowledge, or recall, of many of the fundamental commercial aspects of these transactions, and his misunderstanding of what was required in order to successfully export the goods, supports our conclusion that he at least suspected, and should have known, that the deals were connected with fraud. Our conclusion is that Mr Hall believed that he did not need to understand the commercial aspects of these deals, or the risks which they entailed because he was merely providing the financing and an entity which could be used by TAP for deals which he should have known were fraudulent."

57. The FTT stated their conclusion on the issue of what WW should have known at [84] – [87]:

> "84. We have concluded that WW should have known that these deals were very likely to be connected with fraud, both because of information from HMRC about prevalence of fraud in this market, (Notice 726 and HMRC's letter of 28/11/05) Mr Hall's knowledge of the mobile phone market, including his involvement as a witness in an earlier MTIC case and the lack of commerciality surrounding these transactions. The combination of these would have made a reasonable business person carry out further investigations, which WW failed to do, to ascertain whether these deals were actually connected with fraud. Had Mr Hall undertaken these investigations, he would have been in a position to know that these deals were connected with fraud.
>
> 85. Neither the reputation of TAP nor the actions of HMRC in repaying earlier VAT are sufficient to override these warning signs [identified in the previous paragraph]. The status of TAP should not have persuaded WW, and would not have persuaded a reasonable business person that no further due diligence was required.
>
> 86. If WW was unaware that the deals were connected with fraud, that was based on a determined effort not to ascertain what was actually going on. The Tribunal cannot agree that it was 'inconceivable that a business such as TAP would be involved in fraud'. The Tribunal takes WW's lack of interest and failure to ask relevant questions about these transactions as an indication of their willingness to allow TAP to use WW for deals which they should have known were fraudulent.
>
> 87. The Tribunal has concluded that on the information available to WW, on the basis of what WW and Mr Hall did actually know, they should have considered it highly likely, that Deals 1 – 4 were connected with fraud and that this should have led to further due diligence being carried out. Whether this was not done due to naivety, stupidity, or willingly turning a blind eye, is not possible to be certain from Mr Hall's rather evasive evidence, but whatever the reason, the Tribunal has concluded

that someone in WW's position aware of the circumstances of each of these deals and of the risk of fraud in this market, could and ought to have put himself in a position to know whether or not they were connected with fraud. The test in *Kittel* and *Mobilx* extends to intentionally failing to ascertain fraud, which is what we consider WW did."

Ground of appeal against the Decision

58. WW applied to the FTT for permission to appeal on two grounds, namely that the FTT erred in law by:

(1) misinterpreting the 'should have known' test; and, in the alternative,

(2) finding that the only reasonable explanation for the transactions was fraud.

59. The FTT gave WW permission to appeal in relation to the first ground of appeal but restricted the permission to specific issues raised in paragraphs 13 - 17 of the grounds which concerned the correct application of the 'should have known' test. Paragraphs 13 – 17 were as follows:

> "13. At [87], the Tribunal erred in law when applying the 'should have known test'. It stated:
>
> 'The Tribunal has concluded that on the information available to WW, on the basis of what WW and Mr Hall did actually know, they should have considered it highly likely, that Deals 1 – 4 were connected with fraud and that this should have led to further due diligence being carried out. Whether this was not done due to naivety, stupidity, or willingly turning a blind eye, is not possible to be certain from Mr Hall's rather evasive evidence, but whatever the reason, the Tribunal has concluded that someone in WW's position aware of the circumstances of each of these deals and of the risk of fraud in this market, could and ought to have put himself in a position to know whether or not they were connected with fraud.' [Emphasis added]
>
> 14. The Tribunal has repeatedly in this decision related the risk of fraud to the 'should have known' test. That is insufficient to dismiss the appeal. Having been very clear that the Appellant did not have actual knowledge, the Tribunal is left to only decide whether there is another reasonable explanation that the supply.
>
> 15. In [*Davis & Dann Ltd and Precis (1080) Ltd v HMRC* [2013] UKUT 374 (TCC), [2014] STC 39], the Upper Tribunal ['UT'] recently and correctly interpreted *Mobilx* in the Court of Appeal:
>
> '38. This test presents a high hurdle for HMRC which we think is most easily appreciated by noting that it is not enough that the circumstances of the taxpayer's transactions might reasonably lead him to suspect a connection with fraud; nor is it enough that the taxpayer should have known that it was more likely than not that his purchase was connected to fraud. In other words, he can appreciate that everything may not be right about the transaction but that is not enough. He should have known that the transactions in which he was involved were connected to fraud: he should have known that they were so connected because that is the only reasonable explanation that can be given in the circumstances of the transactions.' [Emphasis added]'

16. The Tribunal does list of certain enquiries that the Appellant could have conducted, but it does not consider whether there is another reasonable explanation, even taking into account this additional knowledge, which is particularly important as each point only refers to risk. At best, the Appellant would merely have identified that there is a further reason for suspicion; suspicion is clearly insufficient.

17. At [80], the Tribunal lists three additional checks that should have been conducted; however, it should have asked itself 'had the appellant known these additional facts, would it have led it to know that the only reasonable explanation these transactions was a connection to fraud.' It made no such consideration, but focused on 3 questions:

'(1) *What are the goods which are the subject of this contract*? Mr Hall knew very little about the details of the type and specification of the mobile phones being imported. Most significant here is apparent lack of interest by WW in the location and security of the goods. These go to heart of commerciality of the deal. The Tribunal would expect this to be clearly established for any type of deal in any market. There is no evidence of inspection of the goods in any of these deals (other than a cursory inspection for Deal 1). If full details of the goods had been ascertained it would have been clear that they were not phones which could have been used in the UK.

(2) *Can these goods be legally sold?* WW failed to obtain actual evidence of import documentation from TAP (the CMR documents). If they had followed this up, TAP would not have been able to provide this. Another basic question which we would expect anyone involved in any kind of commerce to establish. In this instance this meant insisting on the production of CMR documentation.

(3) *What is the character of the seller*? Even in a market where there was no risk of fraud, a certain level of due diligence could be expected for deals of the significance of these to WW. Without any such due diligence, a purchaser risks not just fraudulent dealing but any number of other legal and regulatory risks. For all WW knew he could have been dealing in goods contravening all sorts of laws and regulations. HMRC referred to the 2005 accounts of TAP, which would have been available to Mr Hall (and Mr Langley) which had either of them reviewed them made it clear that TAP had made a £1.6 million loss.'"

60. The FTT refused permission to appeal in relation to the issues raised in paragraphs 18 - 24 of the first ground because they raised matters of fact. The FTT did not refer specifically to the final two paragraphs, 25 and 26, of the first ground and we take it that the permission to appeal extended to the issues raised in those paragraphs which were as follows:

"25. The Tribunal has considered it possible that Mr Hall was naive and not deliberately turning a blind eye. It later, at [79] stated:

'On the basis of Mr Hall's evidence, or in many cases, lack of ability to provide any evidence, the Tribunal's view is that WW intentionally failed to asked *(sic)* questions which <u>might</u> have made it aware of fraud. We think that this puts them in the same category as taxpayers who intentionally ignore the existence of fraud. To use the terminology applied in another similar decision, Mr Hall and WW had at least 'blind eye knowledge' that fraud was the only reasonable explanation for these deals.' [Emphasis added]

> 26. In any test, the word might is not insufficient *(sic)* to dismiss an appeal. The Tribunal has leapt from the conclusion that the Appellant intentionally did not asked *(sic)* questions which *might* have made it aware to suggest that this means it had 'blind eye' knowledge. This is a continuing error in law regarding the 'should have known' test."

61. The FTT refused permission to appeal in respect of the entirety of the second, alternative ground of appeal. In that ground, WW contended that the FTT had erred in finding that the only reasonable explanation for the transactions was fraud because that contradicted the FTT's finding that WW did not have actual knowledge and the history and credibility of TAP provided another reasonable explanation. WW applied to the Upper Tribunal for permission to appeal in relation to the second ground but made no application in relation to those parts of the first ground for which the FTT had refused permission. The Upper Tribunal refused permission to appeal in relation to the second ground on the papers. WW did not seek to renew its application at an oral hearing.

62. Accordingly, WW's sole ground of appeal against the Decision is that the FTT erred in law when applying the 'should have known' test. WW contends that the FTT did not consider, as is required following *Mobilx*, whether the only reasonable explanation for the transactions in this case was that they were connected to fraud. WW maintains that the FTT wrongly focussed on whether WW should have known that there was a risk that its transactions were connected to fraud or that it was more likely than not that its transactions were connected to fraud.

63. WW's skeleton argument and oral submissions before us raised a number of issues concerning the Decision, including criticism of the FTT's application of the 'actual knowledge' test where the FTT had found in favour of WW and matters that, it seemed to us, related to the second ground in respect of which permission had not been given. We consider below those points of law which appeared to us to arise under the parts of the first ground for which permission was given and are capable of determination in this appeal.

Discussion

64. Mr Ahmed contended that the FTT misunderstood the true nature of the test to be applied in determining whether WW should have known that the transactions were connected to fraud. Mr Ahmed submitted that it is clear from *Kittel* and *Mobilx* that, in order to satisfy the 'should have known' test, it is not sufficient to establish that the taxpayer should have known that there was a risk that the transactions were connected to fraud: the correct test is whether the only reasonable explanation for the transaction in which the taxable person was involved was that it was connected with fraud. We agree with this proposition which is clear from [56] and [59] of *Mobilx*.

65. Mr Ahmed argued that the FTT consistently misdirected themselves as to the correct test to be applied and wrongly concluded that WW should have known of a connection to fraud because it should have been aware that there was a risk that the transactions might be connected to fraud. We do not agree. In our view, the FTT correctly identified the test to be applied and went on to apply it. The FTT set out the relevant passages from *Kittel* and *Mobilx* at [6] and [7]. Further, the FTT stated correctly, at [8], that:

> "… in order to prove that a tax payer should have known of a connection with fraud, it is not sufficient for HMRC to establish that 'the taxpayer should have realised it was more likely than not that the transactions were connected to fraud' in order to deny the right to deduct. HMRC must demonstrate that the only reasonable explanation for the circumstances in which the transactions took place is a connection with fraud."

The FTT repeated the correct test and the questions to be asked at [61] and [62] which are quoted at [44] above. The FTT began their consideration of the question of whether WW should have known that the transactions were connected with fraud at [75] by rejecting the notion that it had to establish whether WW should have suspected that fraud was present. The FTT referred again to the need for HMRC to establish that fraud is the only reasonable explanation at [76].

66. Mr Ahmed accepted that the FTT had set out the 'should have known' test correctly in the Decision but he contended that the FTT failed to apply the test correctly. He contended that the FTT based their conclusion that WW should have known that the transactions were connected to fraud on risk which was held to be impermissible in *BSG*. The Court of Appeal in *Mobilx* found that the FTT in *BSG* had erred because it based its decision on whether BSG's director had exercised due diligence or done enough to protect himself from the risk of becoming involved in transactions that might prove to be connected with fraud. Mr Ahmed submitted that the FTT in this case had made the same error.

67. The FTT found, in [73], that the contrived nature of the transactions, which Mr Hall knew about when he entered into them, was not enough in itself to establish that fraud must be the explanation. Mr Ahmed contended that if contrivance did not establish that fraud is the only explanation then the FTT had effectively answered the 'should have known' question in favour of WW. We do not accept that the FTT's conclusion in [73] meant that WW should not be regarded as having known that the only reasonable explanation for the circumstances of the transactions was that they were connected to fraud. In [73], the FTT were considering whether contrivance showed that WW had actual knowledge of fraud. The FTT found that the contrived nature of the transactions was suspicious but did not mean that WW was knowingly involved in the fraud. We accept, however, that the fact that the FTT found that there could be an explanation for contrivance other than fraud means that there must have been something else in the circumstances of the transactions to show that the only reasonable explanation was that they were connected to fraud.

68. The FTT concluded, in [74], that WW did not actually know that the transactions were connected to fraud and, purely on the basis of what it knew, it could not be said that WW should have known that the only reasonable explanation for the circumstances of the transactions was fraud. However, the FTT found that WW's lack of knowledge and awareness was because it had not asked certain questions, notwithstanding the suspicious circumstances described by the FTT in [78] which were known to WW. The FTT found, in [79], that this was WW's deliberate choice. That led the FTT to conclude that Mr Hall had deliberately refrained from asking questions lest his suspicions should be confirmed. The FTT did not go so far as to treat the intentional failure to ask questions in those circumstances as so close to actual knowledge that Mr Hall should be treated as having that knowledge that he deliberately sought to avoid, ie actual knowledge of fraud. The FTT stopped short of that conclusion but found that a

deliberate failure to ask questions, in circumstances where there were grounds to suspect fraud, showed that WW should have known that the only reasonable explanation for the circumstances in which the transactions took place was that they were connected to fraud.

69. Mr Ahmed aimed most of his criticism at [79] of Decision. He contended that the FTT's finding that WW intentionally failed to ask questions which might have made it aware of fraud showed that the FTT were not applying the test correctly. He maintained that the fact that WW 'might' become aware of fraud does not satisfy the 'should have known' test which requires the taxpayer to know that fraud is the only reasonable explanation. Mr Ahmed said that the FTT should have considered whether the questions 'would' have made WW aware of fraud. Mr Ahmed also criticised the FTT for taking evidence of actual knowledge into account in determining whether WW should have known of the connection with fraud. Mr Ahmed contended that the intentional failure to ask questions, or 'blind eye knowledge' as the FTT called it in [79], was evidence that WW had actual knowledge of a connection to fraud. Such evidence was not consistent with the FTT's finding that WW did not have actual knowledge of fraud. Mr Ahmed pointed out that HMRC had not appealed the finding that WW did not have actual knowledge. Mr Ahmed submitted that the intentional failure to ask questions was not evidence that WW should have known that a connection to fraud was the only reasonable explanation for the transactions.

70. We do not accept this submission. The FTT's findings about WW's failure to ask questions are made in the section, beginning at [75], headed "Should WW have known that these Deals were connected with fraud?". We consider that evidence that a person had actual knowledge of a connection to fraud can, where other evidence casts doubt on actual knowledge, also tend to show that the person should have known that there was a connection to fraud. Evidence that an appellant in an MTIC appeal has deliberately failed to ask questions may support a finding of actual knowledge but it does not lead inevitably to that conclusion. The appellant may have been unaware of the risk of fraud or reckless as to the existence of fraud. The fact that an appellant intentionally failed to ask questions about fraud is a relevant but not conclusive factor to be taken into consideration in considering whether the appellant knew or ought to have known of the connection to fraud.

71. In [80], the FTT set out three further enquiries that, had they been made, the FTT considered would have led to a confirmation that these were fraudulent deals. Mr Ahmed said that WW did not accept that it should have made any further enquiries as TAP was a reputable company and, in any event, the answers to the suggested enquiries would not necessarily have revealed the existence of fraud or grounds to conclude that the only reasonable explanation was a connection to fraud. It is not, however, necessary for us to decide whether the answers to the enquiries postulated by the FTT would or would not have shown that the transactions were connected to fraud as it appears to us that falls under the second ground of appeal for which permission was not given.

72. In [82], the FTT found support for their conclusion that Mr Hall at least suspected and should (in the sense that, if he had made proper enquiry, he would) have known that the only reasonable explanation for the transactions was that they were connected to fraud in the fact that Mr Hall had very little or no knowledge or understanding of the commercial aspects of the transactions.

73. Having reminded themselves, in [83], that the 'should have known' test is a stringent one and that a number of suspicious circumstances is not generally sufficient to meet it, the FTT stated their conclusion on the issue of whether WW should have known that the transactions were connected to fraud at [84] – [87]. We consider that when these paragraphs are read as a whole, the logic of the FTT's approach is clear and may be summarised as follows:

> (1) On the basis of Mr Hall's knowledge of the mobile phone market, the existence of MTIC fraud in it and the lack of commerciality of the transactions, the FTT concluded that Mr Hall should have known that the transactions were very likely to be connected to fraud and, accordingly, should have made further enquiries.
>
> (2) The FTT found in [84] that, had Mr Hall made further enquiries, "he would have been in a position to know that these deals were connected with fraud".
>
> (3) The FTT found, in [86], that WW could have put itself in a position to know whether the transactions were connected with fraud but intentionally failed to do so by "a determined effort not to ascertain what was actually going on". The FTT concluded that WW's lack of interest and failure to ask relevant questions showed that WW was willing to allow TAP to use it for deals that WW should have known were fraudulent.
>
> (4) The FTT held, in [87], that the 'should have known' test in *Kittel* and *Mobilx* extends to intentionally failing to ascertain fraud which is what WW did.

74. In our view, the word 'would' in the FTT's conclusion in [84] shows that the FTT did not misinterpret or misapply the 'should have known' test as explained in *Mobilx*. The FTT were right to hold that WW could not put itself outside the test by deliberately not asking questions that would have led it to conclude that the only reasonable explanation for the deals was that they were connected to fraud where it knew that fraud was an issue. That is clear from the ordinary meaning of 'should have known' in *Kittel* and the explanation of that phrase in [51] of *Mobilx* where Moses LJ demonstrated that it has the same meaning as the phrase 'having any means of knowing' in [55] of *Optigen* as well as the passage in [57] of *Mobilx* set out at [13] above. Accordingly, we do not accept that the FTT made any error of law in the interpretation or application of the 'should have known' test in this case. In the absence of any error of law, WW's appeal must be dismissed.

Disposition

75. WW's appeal against the Decision is dismissed.

Costs

76. Any application for costs in relation to this appeal must be made within one month after the date of release of this decision. As any order in respect of costs will be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008 .

The Hon Mr Justice Newey

Greg Sinfield
Judge of the Upper Tribunal

Release date: 26 August 2015