Appeal number: FTC/76/2011
[2012] UKUT 173 (TCC)

VAT – alleged MTIC fraud – whether the Appellant knew or ought to have known that its transactions were connected with the fraudulent evasion of VAT – whether HMRC were able to prove that in relation to the relevant transactions there had been a fraudulent evasion of tax

UPPER TRIBUNAL

TAX AND CHANCERY CHAMBER

MY SECRETS LIMITED **Appellant**

- and -

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

TRIBUNAL: MR JUSTICE BRIGGS
Sitting in public at the Rolls Building, Royal Courts of Justice
Mr Timothy Brown of Counsel for the Appellant

Mr Mark Bryant-Heron and Mr George Rowell of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against the Decision of the First-tier Tribunal ("the Decision" and "the Tribunal" respectively) which dismissed (in part) the taxpayer's appeal against a decision of the Commissioners by letter dated 28 January 2008 denying repayment of input tax of £819,280 in respect of VAT returns for the periods ending 30 June 2006 and 31 July 2006. The Tribunal allowed the taxpayer's appeal in relation to the July return on the ground that HMRC had failed to show that the member of the appellant's supply chain which had failed to account for VAT (namely V2 (UK) Ltd) had acted fraudulently. The appeal in relation to the June 2006 VAT return was dismissed on the grounds that the transactions by reference to which the input tax was claimed were connected with fraud and that the appellant ought to have known that they were. There is no challenge on this appeal to the Tribunal's finding that the June transactions were connected with fraud. The sole ground of the appeal is that the Tribunal were wrong to conclude that the appellant ought to have been aware of that. Recognising that this was primarily a finding of fact, the appellant submits that it involved an error of law, either because there was no evidence to support that finding, or because the Tribunal made that finding by reference to irrelevant factors, or without regard to relevant factors.

2. In practice the presentation of the appeal consisted of a challenge to most (but not all) of the specific reasons which the Tribunal gave for its conclusion that the appellant ought to have known that the June transactions were connected with fraud. It is nonetheless convenient, before addressing those reasons directly, to set out the essential background, none of which was in dispute on this appeal.

3. The June transactions formed part of four substantial multi-layered sales of mobile phones, each of which were constructed for the purpose of the perpetration of what has come to be known as MTIC fraud. The uninitiated will find a description of its essential features in paragraph 25 of my decision in *Megtian Limited v HMRC* [2010] EWHC 18 (Ch). The appellant My Secrets Limited was the exporter in the four dirty chains, at the head of which was an importer which dishonestly failed to account for output tax on its sale of each consignment of mobile phones to a buffer within the UK.

4. The June transactions were contracted on the 22, 23 and 28 June, the last two being transacted on the same day, the subject matter of separate VAT invoices, but arguably otherwise forming two parts of a single transaction.

5. Each transaction consisted of a purported sale by way of export of a large consignment of European specification mobile phones, for purchase prices of £759,000, £771,000, £390,000 and £704,000 respectively. In each case the appellant acquired the phones, without any attempt to test the market, from its sole supplier Kingswood Trading Services Ltd ("Kingswood") a company controlled by a Mr Ian Tuppen. The June transactions represented the appellant's first ever trades in mobile phones, although it had previously traded with Mr Tuppen in the purchase and sale of international calling cards.

6. The appellant had since its incorporation in December 2002 been owned and controlled by a Mr Joseph Kemal. By June 2006 it employed as a trading manager a Mrs Denise Leach. It was at Mr Tuppen's suggestion that the appellant decided to become involved in the export of mobile phones.

7. The Tribunal found (and this is not challenged) that by June 2006 Mr Kemal had become well aware that trading in the export of mobile phones carried with it a risk of becoming involved in VAT fraud, having been visited by HMRC's officers in 2003 and 2004, during which the risks were explained to him. He had admitted in cross-examination both knowledge of the existence of MTIC fraud and awareness that it was rife in relation to trading in mobile phones.

8. The Tribunal accepted Mr Kemal's and Mrs Leach's evidence that they had themselves acted honestly in relation to the June 2006 transactions, and that they did not actually know that they were connected with fraud. The Tribunal set out its reasons why, nonetheless, the appellant through Mr Kemal and Mrs Leach ought to have known that the June transactions were connected with fraud in paragraphs 292 to 309 of the Decision. I will locate the specific reasons given by the Tribunal by reference to the numbered paragraphs of the Decision, using the abbreviation "D" followed by the number. At D293 the Tribunal noted that all of the trades (described as "deals") by which each chain was constituted occurred within a single day, and therefore within too tight a time frame for each of them to have been separately negotiated at arms' length. Ignoring the original import, in each chain involved five trades. It is an unavoidable consequence of the unchallenged finding that each of the chains involved the commission of MTIC fraud that none of them involved genuine arms length transactions. Rather, they were all orchestrated to give that appearance.

9. Mr Brown for the appellant submitted that this finding could not constitute any part of the Tribunal's proper reasoning for the conclusion that the appellant ought to have known that the July transactions were connected with fraud, because there was no evidence that the appellant knew that the chains were each put together in a single day. I consider this criticism to be misconceived. There is indeed no finding that the appellant knew this. D293 merely sets out part of the (now unchallenged) background, against which it was necessary for the Tribunal to decide whether, on the balance of probabilities, the appellant failed to take the reasonable precautions required of it before participating in the train of transactions which in fact occurred.

10. In D294 the Tribunal described Mr Kemal's and Mrs Leach's evidence as "honest but naïve". They noted (correctly) that although an experienced businessman, he was operating in a new area of which he knew nothing, and that he relied on Mrs Leach to do all the "necessary checks and due diligence". The Tribunal found that for her part Mrs Leach relied on Mr Kemal's judgment whether to trade with Mr Tuppen and Kingswood, apart from being reassured by a visit to the appellant's premises by Mr Tuppen's solicitors, who appeared reputable. Later at D303 the Tribunal found that the fatal flaw in the

11. At D295 (and again at D304) the Tribunal noted that Mrs Leach did not think to ask Kingswood why it should permit the appellant to make a profit on exporting each tranche of phones, rather than seek to export them itself. Mrs Leach's evidence in cross-examination was indeed that she did not ask Kingswood that question. She said in cross-examination, that, not being the owner of the business, she did not consider it her role to ask any such question of her supplier. As to her own state of mind, she said:

> "For all I know, Mr Tuppen might not have been able to finance the export."

As the Tribunal noted, Kingswood was committed to providing very substantial unsecured credit to the appellant in connection with the June transactions, each of which involved the physical export of the goods on the date of contracting, with payment a week later. In my judgment, considered thought or enquiry by the exporter as to why its supplier was content to let it export, rather than to seek to export directly, is plainly an aspect of the reasonable due diligence expected of an exporter which wishes to make an input tax VAT claim in connection with its acquisition of the goods. It does not of course follow that, regardless of any other due diligence, an exporter which does not make that enquiry will fail to qualify for its VAT reclaim. The question in every case is whether, having regard to the enquiries that might have been made by the exporter, such if any enquiries as were made satisfy the requirement (inherent in the scope of the right to reclaim) to take reasonable precautions.

12. At D296 to 297 the Tribunal set out four types of enquiry specifically identified by the Court of Appeal in *Mobil X Limited v HMRC* [2010] EWCA Civ 517 as questions which Tribunals considering such cases might well need to consider when assessing the state of knowledge of an exporter in an MTIC chain. The Tribunal noted that neither Mrs Leach nor Mr Kemal had asked themselves any of those questions. I need not set them out in this judgment, but they all relate to the general question why the exporter might have supposed that it was being, in effect, invited to take on the profitable role of intermediate seller in substantial transactions concerning mobile phones without any prior track record or proven ability to find customers.

13. Mr Brown submitted that it was inappropriate for the Tribunal to treat Moses LJ's list of useful questions for Tribunals without further ado as a list of questions which the exporter ought itself to consider. I disagree. The reason why those questions are likely frequently to assist the Tribunal in assessing the exporter's state of knowledge is because they are all directed at what might ordinarily be supposed to go through the honest and reasonable mind of a potential exporter in the appellant's position. If a tribunal concludes that such questions probably did go through the exporter's mind, but that he deliberately refrained from making enquiry about them, then that may in accordance with settled law lead to a conclusion that the exporter was a dishonest participant, deliberately refraining from finding to be true that which he already suspected. In a case where, as here, the Tribunal concluded that the two relevant individuals within the exporter (Mr Kemal and Mrs Leach) did not even ask themselves those questions, then the Tribunal may conclude that they were honest but naïve, unreasonable and/or careless in their attitude towards participation in the relevant transactions.

14. At D300 the Tribunal noted that neither Mrs Leach nor Mr Kemal thought to question why mobile phones of European specification were on the market for sale in the UK, and specifically disbelieved Mr Kemal's attempt to explain why that might be so. Reference to the evidence shows that the chargers supplied with European specification mobile phones typically have a two-pin plug, rather than one which conforms to UK specifications. Mr Kemal's lame explanation (sensibly rejected in my judgment) was that users in the UK might be able to charge their mobile phones from shaving sockets. Again, it seems to me that all the Tribunal was doing at this stage in its analysis was to identify yet further questions which an honest and reasonable trader might have asked, but which Mr Kemal and Mrs Leach did not.

15. At D301 and 302 the Tribunal noted that on four occasions within a few days in June the appellant had been contacted by overseas EC customers unsolicited, requesting precisely the models of mobile phones which Kingswood were able to supply, so that the appellant was never exposed to holding unsold stock in its first participation in a wholly new market. The Tribunal accepted HMRC's submission that this was "too good to be true", and concluded that there could have been no reasonable explanation for this in the appellant's corporate mind, consistent with believing itself to be involved in genuine arms length trading.

16. Review of the evidence shows that this is indeed what appeared to have happened on the first and second of the June transactions, and that on all four or (treating those on the 28 June as one transaction) three of them the enquiry from the EC customer was wholly unsolicited. The appellant did not advertise itself anywhere as a UK exporter of mobile phones, and had prior to June 2006 no track record at all of doing so, which could have formed the subject of a word of mouth recommendation.

17. Mr Brown submitted that, if the documents generated on 28 June were to be accepted at face value, there appeared to have been a broader enquiry (both in terms of type and quantity) for mobile phone exports from the appellant's EC

18. More generally, it seems to me that the Tribunal's finding that the circumstances in which the first four (or three by date) of the appellant's large transactions in a wholly new market could not have been regarded, without serious enquiry, as having arisen from genuine commercial causes, rather than by some form of behind the scenes orchestration, seems to me wholly supported by the facts.

19. The conclusion in D303-305 that no-one within the appellant took responsibility for asking reasonable questions (of themselves or of their counterparties) about the numerous alarm bells as to the commerciality of the June transactions is simply not challenged. It was a conclusion well supported by the evidence (once the Tribunal had decided, as it was entitled to do, that the appellant, Mr Kemal and Mrs Leach all acted honestly).

20. The appellant dealt with the receipt from its export customers and payment thereby of the bulk of the purchase price due to Kingswood (all on the same day) by accepting an unsolicited approach from First Curacao International Bank to provide the requisite banking facilities. In fact, although there is no finding that the appellant was aware of this, the whole of the payment flow in connection with the four dirty chains of which the June transactions formed part, apart from the appellant's funding of the VAT element with which the missing trader at the head of the chain absconded, was handled, again in each case on a single day, within FCIB, the money in substance simply going round in a speedy circle.

21. At D306 the Tribunal found that this unsolicited approach to the appellant from FCIB gave rise to no questions in Mr Kamal's mind, although the Tribunal noted that:

> "We gained the impression that they believed that both their customers and the FCIB representative had been directed to them as a result of Mr Tuppen's endeavours."

This conclusion and the "impression" based upon it are not challenged by the appellant. If true, it affords all the more reason why it should have been surprising to the appellant why Mr Tuppen and Kingswood wished to invite it into the profitable role of exporter, with no market contacts or previous experience, if the June transactions had a genuine commercial purpose.

22. Finally, at D307 the Tribunal noted from the agreed schedule of timings to which I have referred that, even if the content of some of the apparently transactional documents had been preceded by telephone communications, it was nonetheless "just too good to be true" for very large transactions to have been "completed" in each case within a very short time after the initial contact from the appellant's customer. Mr Brown submitted that the June transactions took, on average, more like a week to complete, if by completion the Tribunal meant to include not merely the conclusion of binding contracts, but full performance of them by both parties. Accordingly, he submitted that this aspect of the Tribunal's conclusion was based on a mis-reading of the evidence.

23. In my judgment there is no basis for the Tribunal's reference to the completion of the deals in D307 to have been intended as a reference to the completion of performance, rather than merely the completion of any exchanges necessary to give rise to a binding contract. The Tribunal was well aware that payment for the goods exported was not simultaneous either with contract for the export, or even with the physical export of the goods, hence its reference at D295 to the claimant being given substantial unsecured credit by Kingswood. If as I consider the Tribunal intended, D307 is read as a description of the very short times which elapsed between first contact and the making of binding export contracts, then that finding is both entirely consistent with the evidence and supportive of the overall conclusion that, in the eyes of honest and reasonable traders, the June transactions were too good to be true.

24. That concludes my detailed review of the specific criticisms of the Decision made on this appeal. This is of course an appeal limited to matters of law, and it is therefore incumbent upon an appellant which seeks to challenge an essentially factual finding (as Mr Brown conceded that it was) for it to be shown that the challenged finding was not available to the Tribunal on a review of the relevant evidence as a whole: see generally *Edwards v Bairstow* [1956] AC 14, *HMRC v S & I Electronics plc* [2012] UK UT (TCC) at paragraph 40, the *Megtian* case (supra) and, in particular, *Georgiou v Customs & Excise Commissioners* [1996] STC 463, per Evans LJ at 476.

25. Mr Bryant-Heron for HMRC drew my attention to a number of other aspects of the evidence which, he submitted, once aggregated with such of the Tribunal's findings as survived Mr Brown's criticism, amply justified the conclusion that the appellant ought to have known that the June transactions were connected with fraud. I agree. Indeed, for the reasons which I have given, the grounds of appeal have on analysis made such small inroads into the Tribunal's own reasons for its conclusion that those reasons are themselves sufficient to support that conclusion as being free from any error of law. It is therefore unnecessary for me to examine the further factual matters relied upon by HMRC on this appeal. They included a more detailed analysis of the timings derived from the agreed schedule than I have thus far conducted, reference to the unthinking use by the appellant of freight forwarders apparently already engaged by Kingswood, the inadequate specification of the products in the negotiating documents, by comparison with the specification later required in the written orders, and the apparent readiness of the appellant to release valuable consignments of goods for export without obtaining any security for payment from overseas customers with whom the appellant had had no previous dealings of any kind. Taking all those matters in the aggregate (and it is their aggregate rather than piecemeal effect which matters for present purposes) I consider that, far from disclosing any error of law, the Tribunal's Decision was plainly correct.

26. This appeal must therefore be dismissed. It has been agreed that costs should follow the event of the appeal. The appellant must therefore pay HMRC's costs of the appeal.

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

MR JUSTICE BRIGGS

RELEASE DATE: 24 May 2012