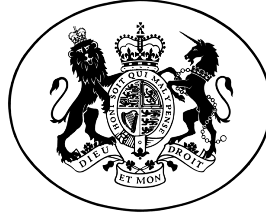

TC02791

Appeal number: LON/2008/0100 & LON/2008/1003

Value Added Tax – whether appellants' transactions were connected to MTIC fraud – yes – whether appellants knew or should have known of connection –yes - appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

KCORP LIFESTYLE LIMITED **HENDON IMPORT EXPORT LIMITED**	**Appellants**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE ALISON MCKENNA
LYNNETH SALISBURY

Sitting in public at the Royal Courts of Justice from 16 to 19 and 22 to 25 October 2012 and at the Finance and Tax Tribunal, Bedford Square on 5 December 2012

Andrew Young of counsel instructed by LexLaw Solicitors for the First Appellant

Mr Holland of Dass Solicitors for the Second Appellant

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

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DECISION

Background

Factual Background

1. These appeals concern fourteen transactions ("the deals") involving the ultimate export of mobile phone handsets to EC member states. In relation to thirteen of the deals, the First Appellant ("K Corp") reclaimed input tax. In relation to the final deal, the Second Appellant ("Hendon") reclaimed input tax. In all but one of the deals, the parties traded with each other. HMRC refused both Appellants' claims for input tax credit on the basis that the deals were connected with the fraudulent evasion of VAT and that both the Appellants, through their directors, knew or should have known this.

2. HMRC's decision to refuse the First Appellant's claim was contained in its letter dated 14 December 2007, which is appealed by virtue of an amended Notice of Appeal dated 21 December 2007. The refused claim was for input tax credit amounting to £1, 438,621.80 for the VAT periods 02/06 to 06/06.

3. HMRC's decision to refuse the Second Appellant's claim was contained in a letter dated 27 March 2008, which is appealed by Notice of Appeal dated 29 April 2008. The refused claim was for input tax credit amounting to £295,386.87 in VAT period 07/06.

Procedural Background

4. These appeals were directed to be heard together at a hearing commencing on 15 October 2012. The hearing originally had a time estimate of 15 days as the Appellants' representatives had unfortunately not complied with the Tribunal's earlier direction to notify HMRC which witnesses were required to attend for cross examination. However, as a result of some very late concessions by the First Appellant, it was possible to reduce the number of witnesses so that the live evidence was completed in 9 days. The Tribunal re-convened for an additional half day in December 2012 to hear oral closing submissions. Written closing submissions were provided to the Tribunal (in accordance with its directions) in advance of the oral submissions by the Second Appellant and the Respondent, but the First Appellant's submissions were provided at the final hearing only.

5. The two Appellants were originally represented by the same solicitors, but on 17 February 2011 the First Appellant filed a notice with the Tribunal to confirm that it had instructed different solicitors. Throughout the hearing of this appeal, the representatives for both Appellants complained that they did not each have a complete set of the papers and could not afford to pay for the photocopying of the extensive bundle. This situation appeared to have arisen out of the arrangements for hand-over of the papers made between the two firms of solicitors and the

Tribunal was satisfied that HMRC had not sought to deprive either Appellant of the papers. The Tribunal is grateful to HMRC for making additional copies of documents available to the Appellants at public expense in order to ensure that the hearing was fair and could run smoothly. We also note that HMRC paid for the proceedings to be transcribed as both Appellants said they were unable to afford to contribute to this additional cost. The Tribunal has been greatly assisted by the availability of the transcript, especially as it allowed the Appellants' representatives to attend only on those days when witnesses relevant to their own case were called, but nevertheless to read the evidence heard in their absence when it was e mailed to them at the end of each day.

6. HMRC has indicated in its Statements of Case its intention to seek its costs from the Appellants if the appeals are dismissed. We have not yet received submissions as to the applicable costs regime for these appeals. We are content to receive any submissions or applications in relation to costs in writing following the promulgation of this decision.

HMRC's Case

7. Most of the factual evidence was undisputed in these appeals. The Tribunal had before it a substantial bundle of agreed documentary evidence relating to the deals. The hearing bundle comprised some 24 lever arch files. Some of the documents had been supplied to HMRC by the Appellant companies and some of it was produced by HMRC arising from its own investigations. HMRC's case was, in summary, that the deals were each contrived, and in support of this contention it relied inter alia upon evidence of the Appellants' consistent profit margins, of their banking arrangements, of the circularity of funds and of goods in some of the transaction chains, the use of a shared internet server by different parties in the transaction, and the disproportionate market share of certain types of phone involved in certain trades. It also relied upon a number of particular factors in relation to deals three and eight (see [9] below).

8. HMRC contended that the characteristics of the deals provided evidence of contrivance or orchestration which, viewed together with the Appellant companies' directors' undisputed knowledge of the risk of MTIC fraud, provided objective evidence on which the Tribunal could properly find that the Appellants had knowledge or the means of knowledge of the fact that they were involved in fraudulent transactions, so as to satisfy the *Kittel* test.

9. In deal three, there was a chance inspection by Customs officials of a shipment of mobile phones at Dover on 20 February 2006. This revealed a short shipment (1432 phones were present as opposed to the 2000 phones referred to in the shipping documentation). HMRC's case was that it had simply not mattered to the parties that there was a short shipment because this was not an arms' length transaction. It relied on the evidence of their conduct in relation to the short-shipment. HMRC also contended that deal eight was contrived in order to make up the value of the short-fall in deal three and further suggested that the replacement phones in deal eight may not have existed at all so that an invalid

invoice had been produced and the VAT input claim for deal eight could be denied on that basis. Our conclusions as to HMRC's "alternative basis" for refusing the input tax are at [164] below.

The First Appellant's Case

10. The nature of K Corp's case was still unclear at the commencement of the hearing. In advance of the oral evidence given by its director Mr Deepak Kandanchani, both other parties and the Tribunal had (not unreasonably) relied upon the case as set out in pleadings filed on K Corp's behalf and on the contents of Mr Kandanchani's sworn witness statement. However, the late concessions referred to at [4] above had already altered the First Appellant's case before Mr Kandanchani went into the witness box. Subsequently, during his oral testimony, several key components of the case as previously understood were altered and Mr Kandanchani's oral evidence departed materially from that in his earlier witness statement. During Mr Kandanchani's evidence he also produced for the Tribunal fresh documentary evidence, previously unseen even by his own solicitors and counsel.

11. By the time of Mr Young's closing submissions, K Corp's case in summary was that it accepted that the transactions had caused a VAT loss occasioned by fraud, but that Mr Kandanchani of behalf of K Corp did not have knowledge or the means of knowledge of this state of affairs.

The Second Appellant's Case

12. There was only one deal in which Hendon was alleged to be the "broker" (deal fourteen). Mr Holland submitted firstly that the Tribunal could not be satisfied, in relation to this particular deal, that the VAT loss was occasioned by fraud because there was evidence that it had been caused by the insolvency of a trader higher up the chain. He further submitted that, if the Tribunal were satisfied that the VAT loss had been occasioned by fraud, then it was accepted that the fraud was connected to Hendon. However, it was not accepted that Mr Hussain, on behalf of Hendon, had knowledge or the means of knowledge that the company was involved in a fraudulent transaction.

The Issues for the Tribunal

13. The issues for the Tribunal in cases of alleged MTIC fraud are generally: (i) was there a VAT loss; (ii) if so, was it occasioned by fraud; (iii) if so, were the relevant Appellant's transactions connected with such a fraudulent VAT loss; and (iv) if so, did the relevant Appellant know or should he have known of such a connection.

14. In this case, it was clear by the time the hearing commenced (although unfortunately not previously) that the First Appellant's appeal was concerned with issue (iv) only, because issues (i) to (iii) were accepted by it (on advice) in relation to all thirteen transactions in which it was the "broker".

15. The Second Appellant's case had always been that it disputed elements (ii) and (iv) in respect of the single transaction in which it allegedly acted as a "broker".

16. These then are the central issues for the Tribunal to decide.

5 **The Law**

17. It was agreed by the parties and the Tribunal that HMRC bore the burden of proof of showing that the Appellants had knowledge or the means of knowledge that they were involved in fraudulent transactions. It was similarly agreed that the relevant standard of proof to be applied in this matter is the civil standard of
10 the proof on the balance of probabilities.

18. HMRC's case relies on the exception to the right to reclaim VAT input tax, as identified by the ECJ in its Judgment of 6 July 2006 in *Axel Kittel v Belgium* (C-439/04) and *Belgium v Recolta Recycling* (C-440/04) [2006] ECR 1 – 6161 with particular reference to paragraphs 51-61 of the Judgment. Those decisions were
15 summarised in the following passages from the decision of the Court of Appeal in *Mobilx Ltd and others v HMRC* [2010] EWCA Civ 5107 ("*Mobilx*") as follows:

> "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
> 20 "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 it turns out that
> 25 the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in Kittel.
>
> 60 The true principle to the derived from Kittel does not extend to the circumstances in which a taxable person should have known that by his
> 30 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."

35 19. Both Mr Young and Mr Holland submitted that the ECJ had refined the *Kittel* test in the joined cases of *Mahagében kft v Nemzeti Adó-és Vámhivatal Dél-dunántúli Regionális Adó Föigazgatósága* and *Peter David v Nemzeti Adó-és Vámhivatal Dél-dunántúli Regionális Adó Föigazgatósága* [2012] EUECJ (C – 80/11) so that the benefit of the right to deduct can now only be denied on the
40 basis of ECJ case law and that the Tribunal may not now deny input tax on the basis of the Court of Appeal's interpretation of *Kittel* in *Mobilx.* We deal with this submission at [180] below.

20. It is clear from the decision in *Mobilx* that in a hearing involving alleged MTIC fraud, the Tribunal is not required to regard each individual transaction in isolation but can draw appropriate inferences from a pattern of transactions. Moses LJ quoted approvingly a decision of Christopher Clarke J in *Red12 v HMRC* [2009] EWHC 2563 at [111]:

> Further in determining what it was that the taxpayer knew or ought to have known the tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics) and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them.

The Evidence

The Deals

21. The Tribunal had before it much undisputed factual evidence in relation to the deals. This evidence was highly characteristic of MTIC fraud and more than sufficient for us to be satisfied that the deals were contrived. An overview of the fourteen deals included the following features: the involvement of identical participants in identical order in repeated deal chains; the extension of significant amounts of credit in back to back trading throughout the chain; deals of significant value with parties whose credit-worthiness was questionable and about whom their immediate trading partner had little information; the consistent absence of evidence of how the deals were arranged; the movement of the goods in breach of the stated contractual terms and apparently in some instances without insurance cover; the absence of evidence of mutual variation of stated contractual terms; the absence of evidence of complaint when terms were breached or payment delayed; the consistent increase in the value of goods at each stage of the chain, yet without evidence of value added; circularity of funds; circularity of goods; third party payments; the commissioning of inspection reports prior to the date of the deal by parties who did not yet own the goods inspected; exportation of goods without prior payment of the UK participants in the chain; identical banking arrangements by parties facilitating swift movement of funds; and the use of a shared internet server address. The relevant evidence in relation to each deal was as follows.

(a) Deal One

22. Deal one involved the sale of 2000 Nokia 9300i handsets. The deal chain started with RM Electrical Wholesalers Ltd, then the phones passed through PM Wholesale Electrical Ltd to AS Genstar, to Quality Import/Export, to Hendon and to KCorp, which exported them to Medius Trading AG (Switzerland). A single purchase order from Medius underpinned deals one, three and four. The trades all took place back to back on the same day, 20 February 2006.

23. The value of the export was £837,400.00. HMRC's case is that VAT of £137,620.00 was lost in relation to it. There were no documents in evidence which detailed any oral or faxed communication between the traders, either in

terms of how the deal was agreed between parties or relating to any agreements to vary the standard terms on the written invoices. None of the participants in the chain were Authorised Dealers or Retailers.

24. There was a price increase from £393.10 to £418.70 per unit, representing a 6.5% gain, as the goods travelled down the chain. There was no identifiable value added by any of the participants at any stage. No dealer in the chain made a loss. Only very brief details were given on the majority of invoices and inspection reports, yet the goods apparently met the buyers' requirements as no goods were refused or returned throughout the chain. The evidence was that K Corp made a profit of 6% per unit on its sales to Medius.

25. The chain in deal one can be traced back to the "hijacking" of RM Electrical Wholesalers Ltd's name and VAT registration. It was undisputed that on 10 September 2007 a protective assessment of £30,309,319 of unpaid VAT was sent to the company then purporting to be RM Electrical. No response or payment was made and there was therefore a loss to HMRC.

26. The goods in deal one were exported by K Corp to Medius Trading AG, a Swiss-based private company apparently registered on the 28 September 2005 (less than 6 months before the sale by K Corp). The company does not disclose any financial details. Its registered address is that of Gerber and Treuhand Fiduciary and Trust Services and the sole director is Bruno Gerber, a Swiss Citizen. The company is managed by Zia Khan, a British Citizen resident in Marbella, Spain.

27. The Medius purchase order seen by the Tribunal made clear that payment '*will be made upon delivery and inspection at Trans Sped AG and goods that do not comply will be shipped back to the supplier at their expense*.' The exported goods in deal one were delivered to Trans Sped AG, a Swiss based freight company of Medius'choice (which also served as its referee).

28. The phone handsets in deal one were of European specification. The Tribunal heard that no mobile phones are manufactured in the UK and therefore that these must have been imported goods, despite the fact that they were not originally intended for sale in the UK (where a three pin charger would be required). The Tribunal heard that the chargers could be replaced with a three pin version, however we note that this would involve extra cost and the breaking of the manufacturers seal on the packaging (which would impact on the manufacturers' warranty).

29. The goods in deal one remained within the freight company MSG's warehouse throughout the majority of the sales down the chain until shipped to Trans Sped. The inspection report prepared by MSG at K Corp's request was dated 18 February 2006 (as were those for deals 2, 3 and 4) although the purchase order from Medius and other invoices were dated 20 February 2006.

30. The International Consignment Note dated 20 February 2006 states that the goods were shipped '*on hold until released'* along with 1600 Nokia 6650 (Deal four) by MSG Freight to Medius Trading, c/o Trans Sped. In all the steps in the chain the goods were shipped '*on hold'* and since no payment was made to any supplier until K Corp received payment from Medius, it is unclear whether K Corp ever acquired legal title to the goods before passing them on. Hendon's invoice to K Corp states '*Terms: To be paid as arranged'* but Hendon clearly had not received title to the goods from Quality Import/Export Ltd since its invoice stated clearly '*Goods remain property of Quality Import/Export Ltd until payment received in full.*

31. The evidence before the Tribunal indicated circularity of funds within deal one. The relevant bank records from the First Curacao International Bank in the Netherlands Antilles ("FCIB") showed that the funds paid to K Corp on 21 February 2006 by Medius were received by Medius from Imedic Industrial Medical of Portugal on the same day, and had in turn been received from Bespoke International of Dubai on the same day having been received from Destonia General Trading, a Cyprus based company, on 20 February 2006. The funds paid by K Corp to Hendon on 21 February 2006 were in turn paid to Quality Import/Export on the same day and Quality, also on the same day, paid Genstar. Genstar paid £918,850.00 to Destonia General Trading for the goods purchased on 20 February from PM Wholesale Electrical Ltd. Destonia also received £1.49m from Genstar on 20 February, which it in turn used to make the payment to Bespoke International the same day. The entire circularity of payments took place in slightly less than a twenty four hour period: at 18:24:06 on 20 February 2006 Destonia made its payment to Bespoke International and by 16:39:34 on 21 February 2006 Genstar had made its second payment to Destonia.

32. The failure to pay PM Wholesale meant that the first trader in deal one had insufficient funds in its accounts to pay the output tax charged on its sales invoice. HMRC will not be able to recover the VAT due from it.

(b) Deal 2

33. Deal two involved the sale of 2000 Nokia 9300 handsets on 20 February 2006. The participants in the chain of transactions were identical to those in deal one, with all the trades conducted back to back on the same day. As with the other deals there were no Authorised Dealers or Retailers in the chain.

34. The value of the export by K Corp was £466,400.00, with a VAT loss to HMRC of £76,405.0. Deal two was traced back to the same hi-jacked trader, R&M Electrical Wholesalers Ltd, with the same loss to HMRC as identified in deal one.

35. We had in evidence no trading agreement documentation other than invoices. The phones were, as in deal one, of European specification and with 2 pin plugs.

36. The unit price increased from £218.10 to £233.20 (a 6.9% increase) through the chain but again there was no evidence of any value added as the phones changed hands. In deal two, K Corp's gross profit margin was 5.9% and Hendon's gross profit margin was 0.45%. There was no evidence of any loss incurred by any of the members of the dealing chain. There was no evidence of any of the goods being rejected or returned to the seller.

37. The Inspection Report prepared for K Corp by MSG was, as in deal one, dated 18 February 2006 (two days before the transaction was stated to have taken place). The goods remained with MSG until shipped to Trans Sped and we had no evidence that the Appellants ever saw the goods. The International Consignment Note dated 20 February 2006 showed the goods as shipped on hold, along with 2000 Nokia 8800 (deal three) by MSG Freight.

38. The goods transferred down the chain as 'shipped on hold' raising the same issues as to legal title as in deal one. The chain participants apparently extended some £500,000 unsecured credit (gross i.e. including VAT) throughout the deal, until payment was made on 21 February 2006.

39. Deal two showed the identical pattern of circularity of payment as in deal one and once again, no payment was made to PM Wholesale.

(c) Deal Three

40. Deal three purported to involve the sale of 2000 Nokia 8800 handsets in response to Medius's purchase order dated 20 February 2006. The chain of participants was exactly the same as in deals one and two, with all trades conducted back to back on the same day. The transaction started with the same hijacked trader as in deals one and two. Once again, the chain did not include an Authorised Distributor or Retailer.

41. K Corp agreed to export the phones to Medius Trading AG, at a value of £1,028,200.00. HMRC's loss is stated to be £169,155.00. Delivery was once again to Trans Sped.

42. There was no trading agreement documentation in evidence apart from the purchase order and invoices. K Corp's profit margin on the export was 6%. Hendon's margin on the sale to K Corp was 0.20%. The price per unit increased from £483.10 at the start of the deal chain to K Corp's export price of £514.10, but again there was no evidence of any value added along the chain. In deal three, approximately £1m of credit was apparently extended from the original seller right down the chain, until payment was made.

43. MSG conducted the Inspection Report (dated 18 February 2006) which showed that it was only holding 1,432 units so that 568 Nokia 8800 phones, with a value in excess of £1/4 million, were missing. There is no documentary evidence that Medius, K Corp or Hendon made a complaint about the shortfall.

No record was kept of what was agreed by way of compensating for the error when it was registered by the participants. Payment in full was made to K Corp on 21 February 2006, despite the shortfall in delivery.

44. The Inspection Report supplied by MSG and dated 18 February indicates that it was holding only 1432 units for K Corp's account and yet it also stated that '*All goods were present, verified and accounted for*'. The goods had been held by MSG at least from the time they were traded by Quality Import/ Export Ltd until they shipped to Switzerland on K Corp's Instructions. The MSG Inspection Report before the Tribunal stated "*no stamps present"* which is contrary to the Customs Examination findings (see below).

45. The International Consignment Note dated 20 February 2006 indicated that MSG transported 2000 units of Nokia 8800 along with 2000 Nokia 9300 (deal 2) to Medius Trading c/o Trans Sped AG but an Export Declaration of the same date only records 2000 Nokia 9300 and only 1432 Nokia 8800. A Customs examination conducted in Dover on 20 February 2006 identified that the actual consignment, as opposed to the information on the Consignment Note, contained only 1432 units of the Nokia 8800 and that the cartons containing both the 8800 and the 2000 9300 bore Dutch Customs Inspection Stamps indicating that they had passed through Schipol Airport on 30 November 2005 (some 2 ½ months earlier) en route to the UK from Dubai. Some of the cartons containing the 8800 phones had 'cut outs' which may have indicated an attempt to remove evidence of customs stamps. The documentation accompanying the shipment recorded incorrect commodity codes.

46. The documentary evidence suggested that the phones had passed from Hendon to K Corp before Hendon owned them, and that K Corp had exported the phones to Medius before it had acquired ownership of them. This was because the written contractual terms between Quality (Hendon's supplier) and Hendon required payment to Quality in full before ownership transferred to Hendon. Hendon's own standard invoice terms referred vaguely to items being paid for "*as arranged*". The shipping CMR for the phones on 20 February 2006 showed K Corp as the consignor, notwithstanding that it had not by then paid Hendon for the phones, so it could not have owned them.

47. As in deals one and two, the evidence showed circularity of funds and third party payments to Destonia.

(d) Deal Four

48. Deal four involved the sale of 1600 Nokia 6680 handsets (described as European specification) on 20 February 2006. The participants in the chain were identical to those in deals one, two and three. The value of the export by K Corp to Medius was £313,760.00, with the VAT loss to HMRC being £51,324.00. K Corp's gross profit margin per unit on the deal was 6%. Hendon, as supplier to K Corp, made a gross profit of 0.54% per unit.

49. As with the other deals, all the trades were conducted back to back on the same day. There was no supporting agreement documentation available, other than invoices.

50. The deal chain was traced back to the hijacked trader RM Electrical, as described in the other deals, and the chain did not include an Authorised Distributor or Retailer. The price per unit increased from £183.10 at the start of the chain to the £196.10 at which K Corp sold to Medius, an increase of 7.1% with no identifiable value added from any of the dealers. No member of the chain made a loss. There is no indication that any of the goods were refused or found not to be satisfactory. The evidence shows that goods to a value in the region of £350,000 were shipped down the chain and abroad with no payment having been made to the original supplier or to anyone else in the chain.

51. An Inspection Report was prepared for K Corp and dated 18 February 2006 (two days before the deal took place). The goods were held at MRG's warehouse from at least the time of Quality's sale to Hendon until they were shipped to Switzerland. An International Consignment Note dated 20 February 2006 indicates that they were shipped '*on hold until released*' by MSG Freight to Medius Trading c/o Trans Sped in the same consignment as deal one. Payment was made to K Corp on 21 February 2006. As with deals one to three, there was circularity of funds. As with the earlier deals, no funds were paid to PM Wholesale which was therefore unable to meet its VAT liability on the transaction.

(e) Deal Five

52. Deal five involved the sale of 620 Nokia 8800 phones (European specification) on 27 February 2006. The deal chain was from Bargain Trade Centre Ltd to Hillgrove Trading Ltd, to Quality Import/Export Ltd, to Hendon, to K Corp and the export was to Medius Trading AG. The value of the sale was £315,456.00 with VAT lost to HMRC of £51,873.85.

53. All the trades were conducted back to back on the same day. There was no agreement documentation available, other than invoices.

54. The chain started with Bargain Trade Centre Ltd which made large supplies of electronic goods, including these, which it failed to declare on its VAT returns and which did not accord with its declared trade class. HMRC raised an assessment of £5.3 million. Bargain Trade went missing from its place of business and failed to respond to letters from HMRC. The assessments remain unpaid and no appeal has been lodged.

55. The export sales were made to Medius Trading AG in Switzerland as in deals one to four concluded a week earlier. Deals five and six both arose as a result of a single purchase order from Medius dated 27 February 2006. Delivery of the goods was made to Trans Sped AG, Switzerland, as in the earlier deals.

56. K Corp made a gross profit of 6% per unit on this deal. Hendon made a gross profit of 0.20% on its sale to K Corp. The chain contained no Authorised Distributors or Retailers. The sale price per unit increased by £30.70 from £478.10 to £508.80, a 6.4% increase, during the course of one day's back to back trading but with no visible value added at any of the steps. No loss to any of the traders was identified. No goods were rejected or returned.

57. A 10% Inspection Report was conducted for K Corp by A1 Inspections and dated 28 February 2006 (the day after the deal was concluded.) The 62 phones inspected were confirmed as being Nokia 8800, 2 pin, stainless steel, and apparently new with limited warranty. The goods were held at Paul's Freight from the sale by Quality until the shipment to Trans Sped.

58. An International Consignment Note dated 28 February 2006 referred to the goods being shipped '*on hold'* by lorry to Switzerland on that date but does not give the vehicle number and it is unclear whether Pauls Freight was the transporter. An Export Declaration dated 28 February 2006 refers to 620 pieces of unspecified mobile phones.

59. Again the trade shows a movement of goods down the chain with no payment at any juncture until the final export sale. The Quality invoice again states clearly that title does no transfer without full payment. As in deals one to four, goods to the value of approximately £350,000 were allowed to move along the chain, giving unsecured credit to unknown/unspecified traders and in this instance payment was not received until 10 days later as K Corp was paid by Medius on 9 March 2006. The FCIB accounts of the participants in deal five also showed circularity of funds.

(f) Deal Six

60. Deal six involved the sale of 2000 Nokia 9300i (European specification) on 27 February 2006. The chain of participants was the same as in deal five, commencing with the missing trader Bargain Trade Centre Ltd. The value of the export by K Corp to Medius was £806, 000.00 with a VAT loss to HMRC of £132,335.00. The evidence showed that Bargain Trade Centre was paid, but that it made an immediate payment out to a Spanish company and so had no funds to pay the VAT.

61. All trades in deal six were made back to back on the one day. There was no agreement documentation available other than the invoices. K Corp made a gross profit of 6% per unit on its transaction. Hendon made a gross profit of 0.26% per unit on its sale to K Corp. There were no Authorised Distributors or Retailers in the chain.

62. The price per unit increased by £24.90 from £378.10 to £403.00, a 6.6% increase, during the course of the chain. There was no obvious value added during the course of the back to back trading to explain the increase. No member

of the chain incurred a loss. No goods were rejected or returned and no complaints were registered.

63. An Inspection Report dated 3 March 2006 (4 days after the trade date) was prepared for K Corp by MSG Freight. The goods remained in MSG's warehouse from at least the date of the trade with Quality until they were shipped to Trans Sped. An International Consignment Note dated 7 March 2006 (8 days after the trade date) shows the goods being transported "*ship on hold*" by MSG to Trans Sped.

64. In this deal, goods to a value in excess of £880,000 gross were traded apparently without payment until 10 days after the raising of sales invoices. There is no evidence of complaint about the delay before K Corp was paid on 9 March. Once again, deal six involved circularity of funds and third party payments.

(g) Deal Seven

65. Deal seven involved the sale of 4100 Nokia 9300i phones (European specification) on 28 February 2006. The deal chain commenced with Destonia General Trading Ltd, then CHP Distribution Ltd, Hillgrove Trading Ltd, Quality Import/Export Ltd, to Hendon, and to K Corp which exported to 2 Trade Bvba in Belgium. The value of the sale by K Corp was £1,558,000.00 with VAT lost to HMRC of £256,147.50.

66. As in the earlier deals, all trades were conducted back to back on the same day. There was no agreement documentation available, other than the invoices. The invoices for 2 Trade were very detailed but not fully adhered to by K Corp – there was no evidence that the phones were Finnish-made, as requested; the delivery deadline was not met; K Corp as the supplier did not have title to the goods as required and there was no evidence that these points were discussed and an agreement to vary 2 Trade's terms obtained.

67. Deal seven can be traced back to CHP Distribution Ltd which made large supplies of electronic goods, including those in deal seven, which it failed to declare on its VAT returns and which did not accord with its declared trade. HMRC raised assessments of £42million which remain unpaid and no appeal has been lodged by the trader, which has disappeared from its principle place of business.

68. The export sales were made to 2 Trade Bvba, a Belgian company which completed its Application to Trade with K Corp on 20 February 2006 (eight days prior to this trade) and did not provide the '*documentation for verification*' until 28 February (the day on which they executed a trade to the value of £1.6 million). An Equifax Report dated 20 February 2006 gives very limited financial data but suggests a credit limit of under £2000 and gives a Risk Score one point above 'High Risk'.

69. Delivery was made, on 2 Trade's instructions, in Holland to ML & Co, a freight company owned by a holding company based in the West Indies and deemed by Equifax to have a credit risk of 'slightly above average'.

70. K Corp made a gross profit of 6.0% per unit on the export trade. Hendon made a gross profit of 0.28% on its sale to K Corp. The chain did not include Authorised Distributors or Retailers. The unit price increased by £23.25 from £356.75 to £380.00, a profit margin of 6.5%, during the course of the day but there was no evidence of value added to justify the increase. No trader was reported as incurring a loss during the course of the transaction. No goods were rejected or returned and no complaints registered, not even by 2 Trade in view of K Corp's failure to meet its detailed specifications.

71. An Inspection Report was prepared for K Corp on 1 March 2006 (the day after the trade was recorded) confirming the units held at its warehouse. The goods had been held by MSG from at least the time of the deal with Quality until shipped to ML & Co.

72. An International Consignment Note dated 2 March shows the goods being transported "*ship on hold"* by MSG Freight. In this instance, 2 Trade's invoice to K Corp specifically stated that '*the supplier must own the stock*' but K Corp had not paid for the stock. Hendon's terms were '*to be paid as arranged*' but Quality's terms stated clearly that '*the goods remain the property of Quality until payment is received in full'*.

73. In deal seven, goods with a value in excess of £1.7million gross moved from trader to trader with no issue raised as to payment and the tying up of such levels of capital, despite the apparently low capital base and narrow operating margins of the participants.

74. Documents from ML & Co released by the Dutch Customs Authority to HMRC show a circularity of goods in this trade. Sales and Purchase Invoices show 4100 Nokia 9300i purchased by CHP Distribution from Cyprus based Destonia General Trading Ltd on 28 February 2006. The evidence showed that 2 Trade instructed ML & Co to release the 4100 bought from K Corp to Global Mobile Leasing on 2 March, while a fax from Global Mobile Leasing to ML & Co dated 28 February (2 days before 2 Trade's instructions, but the date of deal seven) instructs ML &Co to release the 4100 Nokia 9300i to Destonia General Trading. This transaction is confirmed by ML & Co internal documentation.

75. K Corp received payment on 3 March 2006. The banking details confirm circularity in the movement of funds.

(h) Deal eight

76. By the end of the evidence it appeared to be accepted that deal eight had been conducted to remedy the shortfall in deal three. Deal eight involved the sale of

973 Nokia 9300i on 29 March 2006. The chain was from Hendon to K Corp to Medius Trading AG with a value of £292,007.03

77. K Corp's invoice for the 973 Nokia 9300i is dated 20 February 2006 but it was said that the transaction did not in fact take place at least until 29 February, being the date on the second of two invoices issued by Hendon to K Corp relating to the 973 Nokia 9300i. Hendon issued Invoice No 00880 B, recording the sale of 973 Nokia 9300i at £283.12 per unit and dated 20 February, but this made no reference to the redemption of any issued credit note and indeed retains its standard notation: 'Terms: To be paid as arranged'. Hendon's documents also contained a second invoice, identical in all respects to that of 20 February save for the handwritten notation *'makes up for the credit note'*. If a credit note had been issued by Hendon it has not been supplied to the Tribunal. A further invoice No 00895 was issued by Hendon in relation to the 973 Nokia 9300i and dated 29 March and containing the standard notation relating to terms. It is this invoice which HMRC submits has the correct date of the transaction (although an internal HMRC fax indicates that Hendon's Invoice 00895 related to 1000 Intel p4 3.0 ghz 800/2 mb).

78. K Corp's sales invoice for deal eight is dated 20 February 2006 and also retains its standard terms: '*payment on delivery'* addressed to Medius Trading, K Corp's customer in deal three. There was no written record or invoice from Medius to confirm that it was agreeable to the shortfall of 568 units of Nokia 8800 being replaced by the delivery of 973 Nokia 9300i at £ 300.11 per unit.

79. Although K Corp's invoice notes that delivery of the goods would be c/o Trans Sped the transportation documentation dated 7 April 2006 would not seem to confirm that as being the case in this instance. However, the address given for the consignee to be notified of arrival in Zurich is that of Medius.

80. There is no identifiable chain in the case of deal eight, the documentation stops with Hendon, despite the fact that AS Genstar at least issued a credit note in relation to the missing 568 units and dated the 20 February. Despite the lack of an identifiable chain, K Corp as the exporter made a gross profit per unit of 5.99 %. We were unable to calculate Hendon's profit margin.

81. There is no record of complaint from Medius or K Corp (or anyone else in the chain) regarding the short delivery on 20 February and it was not addressed until 29 March, some six weeks later. Medius paid for the full 2000 units on 21 February, thereby effectively extending K Corp an unsecured credit in excess of £1/4 million for a six week period. K Corp had paid Hendon for the full 2000 units on 21 February, as did Hendon its supplier and so on up the chain.

82. The Inspection Report, prepared for K Corp by Capital Logistics, of the goods held in its warehouse, is dated the 4 April 2006 (a further seven days delay from the invoice date). The Inspection Report confirms the phones to be European specification with 2 pin chargers but little else other than a box count and the observation as to the condition of the outer carton and product box. K Corp's

instructions to Capital Logistics, dated 29 March, required the goods be shipped '*on full release to the ... customer*' – an indication that payment had been received.

There is no evidence that payment was made in deal eight, but the original payments for deal three were shown to be circular.

(i) Deal Nine

83. Deal nine involved the sale of 3500 Nokia 8800 (European specification) phones on 23 March 2006. The chain was from CHP Distribution Ltd to V2 UK Ltd, to Quality Import/Export Ltd, to Hendon, to K Corp and export to 2 Trade Bvba. The value of the export was £1,487,500.00 with a VAT loss to HMRC of £244,693.75. All sales were back to back and completed on the same day. There was no additional trading agreement documentation. The deal chain started with a missing trader, CHP Distribution Ltd. The goods were sold to 2 Trade bvba in Belgium, with delivery to ML & Co in Holland.

84. K Corp's gross profit on the transaction was 5.98% per unit. The chain did not contain an Authorised Distributor or Retailer. The deal showed a rise in the dealing price per phone of £25.59 from £399.50 to £425.00, an increase of 6.4% despite no obvious value added being obtained from the chain of transactions. No goods were returned or rejected. No loss was recorded for any of the participants.

85. The Inspection Report prepared for K Corp appears to be dated 22 March (a day before the trades were apparently initiated). The inspection simply counted the boxes and did not appear to include a count or a check of the goods themselves. The stock was collected by Capital Logistics from First Knight Logistics on behalf of V2 and held by them until shipped to ML & Co. The International Consignment Note dated 24 March showed that the goods were to be *shipped on hold* by Capital Logistics to ML &Co in the Netherlands.

86. Payment was made by 2 Trade on 31 March so that K Corp extended credit of some £1.4 million for 8 days after the apparent sale date. The funds in deal nine, as in deals one to seven, moved in a circle from Destonia to Destonia. The evidence showed that it only took two and a half hours to complete the financial circle.

87. CHP made a third party payment including VAT to a company outside the UK with the effect that it no longer had the funds to meet its VAT liability on the trade.

(j) Deal Ten

88. Deal ten involved the sale of 1500 Nokia 9300i phones (European specification) on 23 March 2006. The deal chain was identical to that in deal nine. The value of the sale was £480,000.00 with a VAT loss to HMRC of £78,881.25. At the start of the chain was the missing trader, CHP Distribution. All of the transactions were completed, back to back, in one day. There was no additional trading documentation.

K Corp made a gross profit per unit of 5.9% on its export sale. Hendon made a gross profit of 0.17% on its sale to K Corp. The chain did not include an AD or a retailer.

89. During the course of the chain the price of the phones increased by £19.50 from £300.50 to £320.00 per unit, an increase of 6.48% (in line with that recorded in deals one to seven and nine). There was no apparent value added at any stage in the deal chain to explain the gain. No losses were recorded at any point. No goods were returned.

90. An inspection report, dated 23 March, was prepared for K Corp by Capital Logistics. The Report contained little more information than a box count. As in the previous nine deals, there was no scan of IMEI numbers. K Corp's due diligence on Capital Logistics showed a company in a poor financial state and a proposed credit limit of £0. On 16 March, K Corp paid a deposit of £2000 to Capital which it was unable to repay when requested to do so some five months later. The goods were collected by Capital from White Knight Logistics and remained with Capital until shipped to ML & Co.

91. An International Consignment Note dated 24 March records the goods being shipped on hold by Capital to ML. Payment was not made by 2Trade until 31March 2006. This was some 8 days after the completion of a deal involving goods to the value of some half a million pounds. There is no evidence of complaints from traders whose goods and thus capital have been tied up for this period.

92. There is evidence of circularity of funds in deal ten. CHP made a third party payment including VAT to a company outside the UK thus making it unable to meet its VAT liability on the transaction.

(k) Deal Eleven

93. Deal eleven involved the sale of 2650 Nokia N90 (European specification) phones on 25 April 2006. The deal chain involved C&B Trading Ltd, Highbeam Ltd, Hillgrove Ltd, Hendon, K Corp and export to 2 Trade Bvba. The value of the sale was £730,340.00 with a VAT loss to HMRC of £119,786.63. The transactions were all completed, back to back, on the same day. There was no additional trading documentation in evidence.

94. The chain started with C&B Trading Ltd, which made large supplies of electronic goods, including these, which it failed to declare on its VAT returns. An assessment totalling £22.6 million was raised but the company disappeared from its main place of business and the assessment remains unpaid. No appeal has been lodged. A compulsory winding up order was made against the company on 10 October 2007.

95. The goods were exported to 2 Trade, a Belgian company. Delivery was made to ML & Co in Holland. K Corp made a gross profit of 6% per unit on the export trade. Hendon made a gross profit of 0.19% on the sale to K Corp. The chain did not include an AD or a retailer.

96. The phones recorded a price increase of £17.30 from £258.30 to £275.60, a 6.7% appreciation in value without any obvious value being added at any stage in the chain. No losses were recorded in the chain. No goods were rejected or returned.

97. An Inspection Report, dated 25 April, was prepared by Capital Logistics at their warehouse for K Corp. The report offers little information other than to confirm the number of boxes and comment on the condition of the cartons. There was no scan of IMEI numbers. There is no record of where the goods were located prior to the Inspection Report.

98. An International Consignment note dated 25 April 2006, completed by Capital Logistics, shows 2650 Nokia N90 being shipped on hold by SKD Transportation to ML &Co in Holland. The document is stamped '*Cargo Unchecked*'. Payment for the goods was made on 15 May, some twenty days after the purported date of sale but again there is no record of complaint. The invoices from Highbeam state clearly that the goods remain the property of the company until paid for in full.

99. In deal eleven, as in others, the funds move in full circle from Destonia to Destonia. C&B made third party payments including VAT to a company outside the UK thus removing its ability to meet the VAT Liability on the transaction.

(l) Deal Twelve

100. Deal twelve involved the sale of 650 Nokia 8800 on 27 April 2006. The deal chain was identical to that in deal eleven. The value of the export by K Corp was £258,375.00 with a VAT loss to HMRC of £42,474.25.

101. All the trades were completed back to back on a single day. There was no additional trading documentation in evidence. K Corp made a gross profit margin of 6% on the export. Hendon made a gross profit of 0.13% on its sale to K Corp. The price of the phones increased by £24.10 per unit from £373.40 to £397.50, an increase of 6.5% in one day, despite no apparent value added at any stage along the chain. There was no reported loss in the chain and no reported rejection or return of goods.

102. An inspection report (with no IMEI scan) was prepared by Capital Logistics on 27 April of the goods then in its warehouse. There does not appear to be a record of where they were held prior to their sale to K Corp. The Consignment Note dated 28 April shows the goods being shipped on hold by SKD Transport to ML &Co. The document is stamped '*Cargo Unchecked*'.

103. Payment was not received until 15 May, some 18 days later. Since the traders are identical to those in deal eleven they were collectively denied the use of over £1million of their capital for some 18 days but with no complaint.

104. As in the previous deals there was circulation of funds (within some 2hrs and 48 minutes.). C&B Trading made a payment including VAT to Integralphone, a company outside the UK, thus leaving it unable to meet its VAT liabilities on the transaction. Destonia, Karippa and Integralphone used the same computer IP address

(85.118.171.217) to make the transfers at 14:12:14, 14:18:22 and 17:00:23. This IP address is located in the UK but all the companies are shown as based outside the UK in Cyprus, the Czech Republic and Switzerland respectively.

5 *(m) Deal Thirteen*

105. Deal thirteen involved the sale of 1200 Nokia N91 (European specification) phones on 26 June 2006. The deal chain started with Global Investment Research, then R S Sales Agency, then Highbeam Ltd, then Danum Trading Ltd, then K Corp exported the goods to 2 Trade. The value of the export is £432,000.00 with a VAT 10 loss to HMRC of £71,190.00. All the trades were back to back and conducted on the same day. There was no additional trading documentation.

106. Although the invoice chain started with a purchase order from Highbeam dated 26 June, to RS Sales Agency Ltd and a sales invoice, also dated 26 June from RS to Highbeam (which states the delivery address to be Highbeam's trading address) we 15 have seen two undated communications on the headed stationary of Global Invest Research of Barcelona which indicate that the stock originated with that company. In one undated note Global alerts Ontime Logistics that their driver '*will be calling today to deliver the following stock: 1200x Nokia N91*', the second undated note asks Ontime to allocate the 1200 Nokia N91 to Highbeam UK Ltd. We do not appear to 20 have any further details on Global Investment Research SL.

107. R S Sales made large supplies of electronic goods, including these, which did not accord with its declared trade class. It failed to declare these supplies on its VAT returns (or any other taxable supplies since June 2005) and an assessment totalling £35 million has been raised by HMRC. RS Sales went missing from its principal 25 place of business and failed to respond, the assessments remain unpaid and no appeal has been lodged in relation to them. A winding up order was made against RS Sales Agency Ltd on 13 December 2006.

108. An Equifax report prepared for K Corp on 19 June 2006 states that K Corp's supplier Danum, incorporated in 2003, has been 'dormant' within the meaning of s 30 250 of the Companies Act since that date. Defined as 'a small company' it is exempt from many of the requirements regarding the filing of accounts and as such the financial data available is extremely limited. Equifax put its credit limit at £500. Since the Equifax Report is dated 19 June (as is a Notification of Intention to Trade sent by K Corp to HMRC Redhill and a Trading Application Form sent by K Corp to 35 Danum) it is apparently the date on which the two companies started to negotiate a trading relationship, and on 26 June they jointly agreed a trade to the value of nearly £1/2 million.

109. K Corp made a gross profit of 5.88% per unit on the export sale. Danum Trading made a gross profit of 0.15% on its supply to K Corp. There were no Authorised 40 Distributors or Retailers in the chain.

110. The unit price increased by £21, from £339.00 to £360.00 (6.19%) over the trading day, despite no apparent value added at any stage in the chain. No losses were reported in the chain. No stock was reported to be rejected or returned.

111. An Inspection Report prepared for K Corp on 26 June by Ontime Logistics is described as '*visual*' and makes no observations as to the specifications of the phones other than to observe that they *were 'in original pax'*, were in '*good/new'* condition with none missing and no marks or damage. A 10% IMEI number scan was conducted but there is no evidence that the numbers thus collected were checked against HMRC's data base.

112. The Consignment Note, dated 26 June, indicated that the goods were shipped on hold by Ontime and transported by Eddie Stobart Ltd via Cross Channel Shuttle on that day. The Note was stamped '*Cargo Unchecked'*. A letter from Stobart, referring only to '*products dispatched by Ontime Logistics'*, dated 27 June and a Euro Tunnel Vehicle Tracking Note confirms the shipment was on 26 June. There is an invoice from Ontime to K Corp for the transportation costs and inspections which amounts to £2,276.35. Payment for the goods was not received until 30 June, four days after the sale of the goods.

113. Once again, the banking evidence shows the funds moved in a circle from Worldcall to Worldcall, and that full circularity was achieved in some 3hr 24min. Although the evidence suggests that RS Sales acquired the goods from Global Invest Research, it made payment to Worldcall. The payment made included VAT, thus leaving RS unable to meet its VAT liability on the trade.

(n) Deal Fourteen

114. Deal fourteen in this case is the only deal in which Hendon claimed input tax. It involved the sale of 3500 LG KG 800 and 1850 Nokia N91 phones on 27 July 2006. The deal chain was from Techbase Consulting Poland ("TCP") to V2, to K Corp, to Hendon and with Hendon exporting to Allimpex Handelsgellschaft MBH. The total value of the export was £1,789,545.00 with a VAT loss to HMRC of £294,975.63.

115. The goods in deal fourteen were invoiced to V2 by Techbase on 26 July 2006. The Tribunal had no copy of a purchase invoice issued by V2 to TCP and can not therefore make a finding as to the date that any purchase order was issued. However, we did have a Consignment Note dated 24 July 2006 from Services Billie Jo SL in Barcelona to A1 Freight which lists 1850 Nokia N91 and 3500 KG800 which is marked "*must deliver 27/7/06"*. This was two days before the sales invoice issued by TCP and three days before the issue of K Corp's purchase invoice to V2.

116. Via a stock acceptance note dated 27 July 2006, V2 accepted delivery of the exact same number and type of phones from A1 as were supplied to A1 by TCP in response to its order. On the same day, V2 instructed A1 to allocate the stock to K Corp.

117. Also on 27 July 2006, Allimpex issued Hendon with a purchase order for 3500 LG KG 800 and 1850 Nokia N91 and Hendon issued a purchase order in the same amount to K Corp. K Corp then issued a sales invoice to Hendon dated 27 July 2006 and marked it '*Goods released on payment'*. On the same date, K Corp instructed A1 to ship the goods '*on hold*' to Hendon with a note that the goods were not to be released pending further instructions from K Corp. On 27 July 2006 Hendon instructed A1 to ship the telephones to Allimpex on a *ship on hold* basis. A Consignment Note dated 28 July 2006 shows the goods being shipped on behalf of Hendon to Trans-Am Logistiks, Germany. We saw no trading documents from Hendon to Allimpex other than a stock offer document dated the 27 July 2006 stating "*Further to our telephone conversation these are the prices we can offer you 3500 LG KG800 @ 318.00 and 1850 Nokia N90@365.7.*" The offer does not specify the currency but Allimpex purchase order indicates it to be Sterling.

118. The Polish Authorities indicated to HMRC on 1 April 2012 that TCP did not have the facilities to trade on such as large scale and replies from other member states indicate that the company was registered '*in order to take part in arranged frauds.*' TCP asked V2 to make payment to Techbase Consulting Ltd of Birmingham ("TCL"), although the two companies appear to have no connection. There were no Authorised Distributors or Retailers included in the chain.

119. The goods were exported by Hendon to Allimpex, a German company based in Berlin. Hendon's Due Diligence Check List was completed on 8 August 2006, some 12 days after Hendon supplied the company with goods to the value of £1.7 million. The due diligence pack includes what appear to be registration documents but they are in German and no translation has been included, there is an undated introduction letter on Allimpex's stationary but no financial data, no details of accountants/solicitors, no references appear to have been asked for or provided. Hendon's due diligence on K Corp was performed (apparently in person) on 19 June and is no more detailed that that conducted on Allimpex. Clearly Hendon and K Corp had significant experience of dealing with each other that predates the Due Diligence Check List included in Hendon's due diligence pack.

120. In this deal, Hendon, made a 6% gross profit per unit on both sales. K Corp makes a 0.17% gross profit on the sale of the LG phones to Hendon and 0.15% on the sale of the Nokia N91 phones.

121. The price per unit for the LG 800 increased by £19, from £299 to £318.00, (a 6.35% gain) and the Nokia N91 by £21.70, from £344.00 to £365.70, (a 6.3% gain) in the course of the trading, despite the lack of any obvious value added at any stage.

122. There was no reported loss in the chain. There was no evidence of goods being returned or rejected.

123. There was no inspection report in the bundle of documents given to the Tribunal although a report of a visit by HMRC officers to Hendon indicated that they had seen documents from A1 relating to the relevant phones which confirmed that they had 2 pin chargers, and appeared to be new with the outer carton in excellent condition.

124. Payments were made to Hendon and from Hendon to K Corp between 4 and 7 August, 9 and 12 days respectively after a sale to the value of £1.7 million without any evidence of complaint from K Corp as to the locking up of their working capital. There is no evidence of circularity in deal fourteen.

5 125. V2 made a third party payment to TCL in the UK rather than to TCP in Poland which had supplied the goods to V2. V2 has not accounted to HMRC for the VAT liability on the transaction as an acquirer. TCL paid the funds received from V2 to Tomsberg Corp SL.

126. The evidence before the Tribunal was that TCL and Tomsberg used the same IP
10 address to make the cash transfers and that the IP address is located in the UK. While TCL is based in the UK, Tomsberg is based in Spain. Bespoke, Worldcall, Racheltel and Allimpex (other parties in the deal fourteen payment chain) also used the same IP address that was used by Destonia, Karippa and Intelgralphone in deal twelve and by Worldcall,Theirra and RS Sales in deal thirteen.

15 *The Appellant Companies*

127. The Tribunal heard that K Corp was registered for VAT from 1 September 2003 and was involved in the manufacture and wholesale of wireless networking products until November 2005, at which point it became involved in the purchase of mobile phones from UK suppliers and the onward sale of those phones to customers in
20 Switzerland and Belgium. With this change to its trading activity, K Corp's turnover increased from £340, 574 in the year ended 30 April 2005 to £19, 413, 237 in the year ended 30 April 2006. K Corp applied for and was permitted to make monthly VAT returns from the period 07/05. Whilst it had previously employed six staff, at this time it reduced its staff so that it employed only its sole director, Mr Kandanchani, and a
25 book keeper.

128. The Tribunal heard that Mr Kandanchani had been awarded a first class BSC degree in Management Sciences by Warwick University. He had completed internships with Citibank in Dubai and with Lehman Brothers. He had worked for Barclays Capital for a year before founding K Corp and working for himself from
30 2002 to 2006. He was awarded an MSC in 2012 and was, at the time of the hearing, working for KPMG as a consultant.

129. The Tribunal heard that Hendon was registered for VAT from 1 July 2003. Its main business activities were described as "*retail/wholesale clothing fabric/import export/clothing fabric*". Hendon's director and principal shareholder was Mr
35 Monawer Hussain. Hendon was dormant from the time of registration until the period 01/05 when it started to trade in mobile phones. The company did not employ any staff. Having been dormant in 2004, its sales figures increased from £324,290 for the period 01/05 to £4,900,955.50 for the quarter 07/06.

HMRC's Witnesses

130. The evidence about the deals was produced by Officers Cheema and Sheteolu. These officers also gave evidence about their respective dealings with the Appellant companies and of the steps taken to make their directors aware of the risks of MTIC fraud. By way of general background, the risk of such fraud was said to have received much publicity in the general and specialist press. In K Corp's case, the risk of fraud was brought to Mr Kandanchani's attention by HMRC's officers at meetings in August, September and October 2005. In August 2005 K Corp was sent a letter by HMRC's Redhill office advising it of MTIC fraud and the need to verify trading partners' VAT numbers. In September 2005 K Corp was sent Public Notice 726 on Joint and Several Liability. This notice gives a list of checks which companies are advised to carry out on trading partners. In August 2005 K Corp's VAT returns became the subject of verification checks by HMRC. The Tribunal heard that Mr Kandanchani had complained about the deferred payment of input tax pending completion of the verification checks.

131. The Tribunal heard that Hendon was selected for verification due to the large repayment claim for the period 07/06. The Redhill letter had been sent to Hendon in July 2004. In February 2005 a further letter referring to the risk of MTIC fraud was sent to Hendon, together with a request for verification of its transactions and a list of monthly sales and purchases. HMRC officers visited Hendon in April 2005. Hendon specifically referred to Public Notice 726 in the due diligence checklist it produced for its suppliers and customers, so can be assumed to be aware of its contents.

132. The Tribunal had before it written evidence from Officer Stone which provided background evidence about the mechanics of MTIC fraud. It also had evidence from Officers Lam and Letherby concerning the FCIB bank records showing rapid circularity of funds and the shared IP server used in some of the deals.

133. The Tribunal heard from Officer Smith with regard to V2 and the *My Secrets* appeal. Officer Smith accepted in cross examination that he would have referred V2 to criminal investigators if he had found evidence of fraud, but that he had not. He accepted that there may have been evidence of insolvency due to V2's customers not paying it but asserted that V2 had nevertheless been involved in fraudulent activity. We consider Mr Holland's submissions arising from this cross examination at [177] below.

134. The Tribunal also heard oral evidence from Mr Fletcher of KPMG about the grey market in mobile phone sales. This was challenged by Mr Holland on the basis that it did not comply with the Civil Procedure Rules' requirements for expert evidence. The Tribunal was content for Mr Fletcher's evidence to be heard but then considered what weight to attach to it in reaching its conclusions. We consider Mr Holland's submissions at [178] below.

The Directors' Evidence

135. The Tribunal heard oral evidence from Mr Kandanchani and Mr Hussain.

136. In his re-examination, Mr Kandanchani raised for the first time a suggestion that he was the victim of a fraud. Mr Hussain also made this suggestion for the first time in his oral evidence, claiming that someone had taken advantage of his lack of business knowledge. The Tribunal asked for some further explanation of this theory but Mr Hussain was unable to provide one.

137. In relation to the lack of contemporaneous documentation about the deals, Mr Kandanchani's witness statement explained that he had kept records in a notebook that had been mislaid and was probably in storage in Dubai. In his oral evidence, he additionally asserted that traders only do trading. He said that keeping records is a job for an auditor or accountant, although we saw no evidence that K Corp had employed such a person for this purpose at the time of the deals.

138. In relation to deal three, neither Mr Kandanchani nor Mr Hussain were able to explain why the documents showed that an inspection report was commissioned by K Corp on 18 February 2006 (two days before the deals were done). On the face of it, this had involved K Corp in expenditure prior to its having any certainty that the deal would be successfully closed. Mr Kandanchani's evidence was that there had been a later, inspection report (not produced in evidence) which had showed the correct amount of phones were in the shipment, although this did not explain the existence of the 18 February report.

139. In relation to the processing of the payment from K Corp's customer Medius, and from K Corp to Hendon in respect of the short shipment of phones in deal three, both Mr Kandanchani and Mr Hussain denied that they had been aware of the shortfall at the time they had made and received payment for the phones, saying they found out about it later. However, this account was contradicted by the available documentary evidence as to inspection dated 18 February (which had identified the short fall). Their explanation for why the date of the credit notes issued to cover the short fall preceded payment, their evidence was that the credit notes had been created later but backdated.

140. As noted above at [46], the documents suggested that both Hendon and K Corp had moved the phones in breach of the contractual terms and before each company had apparently acquired legal title to the goods. Mr Hussain's evidence to the Tribunal was that written terms are often varied by oral communications in any event. Mr Kandanchani's evidence on this point was that he did not understand the legalities of how title passed, but that he had understood the phones to be "*held to Hendon's order*" until he had paid for them.

141. The Appellants' oral evidence in relation to deal three was in summary that the shortfall in the number of phones was rectified by the issuing of a credit note: Hendon received a credit note from its suppliers and issued a credit note to

K Corp; K Corp issued a credit note to its customer Medius. As noted above, the Appellants' cases were that they had no prior knowledge of the short-fall and the credit notes were simply back dated to 20 February so that they coincided with the invoice dates. It was put to Mr Kandanchani that this explanation was inconsistent not only with his witness statement but also with the two letters he had written to HMRC in 2006. In these he had asserted firstly in March 2006 that Medius had cancelled part of the shipment, and secondly in November 2006 that K Corp's supplier did not have 2000 units available. He replied that *"…all this correspondence was written so that we could get them out the door as quickly as possible. Would that have affected the integrity of the communication? Possibly. It does not mean the three parts of the story, as you claim they are, are not all accurate. I am actually confused as to why this is an issue at all to be honest. But there you go"*.

142. Mr Hussain accepted in response to HMRC's counsel's questioning that, if his supplier had not issued a credit note for him, he would have been in a "*difficult*" position with his own customer, K Corp. Mr Kandanchani described how, notwithstanding that this was K Corp's first transaction with it, Medius was prepared to make payment in full for the short shipment and to accept a credit note for the balance of the phones. The documentary evidence produced to the Tribunal showed that the balancing shipment of phones was sent some two months later so that Medius carried the cost of the £300,000 shortfall in value in the intervening period. There was no documentary evidence that a refund was offered or requested by any party, although Mr Kandanchani told the Tribunal in his oral evidence (albeit not in his witness statement) that he had offered Medius a refund on the basis that he could only make it if he first obtained a refund from Hendon.

143. The evidence showed that the phones were sold by K Corp to Medius at a price which discharged the credit note balance because the amount payable was the same as the value of the short fall on deal three. This was a deal in which the handsets were different from those missing from the original shipment. Hendon's documents in respect of deal eight showed that two invoices had been produced for the same shipment of phones: dated 20 February and 29 March 2006 respectively. Mr Husain could offer no explanation for this duplication.

144. K Corp's case had originally been that deal eight was a discrete deal, unconnected with deal three and that the value of the deal (so as to discharge the credit note) was a "*coincidence*". This was the explanation contained in the signed witness statement prepared and served by his former solicitors in connection with these proceedings in 2010. However, Mr Kandanchani's oral evidence to the Tribunal on this point was that the witness statement was wrong because he had meant to say that the deal was "*unrelated with respect to mobile phone model numbers*". He said that there had been mistakes in the witness statement due to the "*manufacture*" of evidence by his previous solicitors Dass, and that he had only heard the witness statement read to him over the phone before signing a faxed copy of the final page confirming that the statement was true, without being able to check the full contents. Mr Kandanchani was cross

examined on the basis that this was not a truthful statement and that he was not a truthful witness, which he denied.

145. Whilst giving his evidence, Mr Kandanchani initially told the Tribunal that he was staying at a hotel during the hearing. However, when asked by his own counsel which hotel this was (so that he could go to fetch his laptop) he said that he was in fact staying at his sister's house. When asked why he had not said this in his earlier evidence to the Tribunal, he said he had been too embarrassed to admit staying with his sister. It was put to him in cross examination that if he were prepared to lie about something as simple as his accommodation arrangements, then his evidence as a whole could not be relied upon by the Tribunal, but he denied being untruthful.

146. It was put to Mr Hussain in cross examination that the assertion in numerous VAT returns that he was an "agent" (and so had only declared his "commission" rather than the true turnover of his business) was dishonest. Mr Husain said that he had merely signed the VAT returns prepared by his accountant, now deceased, and that the details of all the transactions had been submitted with the returns. He had asked his accountant to discuss the matter with HMRC. The Tribunal heard that he had not been penalised for making false returns. It was put to Mr Hussain in cross examination that the reason for the under-declaration of his turnover was to keep his business "below the radar" but he denied this. Hendon's company accounts had also shown him to be an agent receiving commission rather than a principal in his transactions. Mr Hussain's evidence was that this was due to a misunderstanding of his legal position on his and his accountant's part.

Submissions

HMRC

147. HMRC's closing submission was that an examination of the evidence concerning deals 3 and 8, together with the evidence in relation to each of the fourteen deals, enabled the Tribunal to conclude that in the case of each Appellant, it had knowledge of the connection of the transactions to the fraudulent evasion of VAT. In the alternative, HMRC argued that, having regard to the objective circumstances in which the deals took place, each Appellant should have known that it was taking part in a transaction connected with the fraudulent evasion of VAT.

148. HMRC relied upon the level of commercial risk taken by each Appellant in deal three as evidence of contrivance more than sufficient to put an honest trader on notice of fraud. HMRC pointed to the lack of written complaints or demands for re-payment between the parties in respect of the short shipment, and the equanimity with which a serious breach of contract and exposure to liability was apparently viewed by the parties. It further suggested that deal eight was manufactured in order to regularise deal three and that there was no evidence that the phones in deal eight actually existed. In this regard, HMRC advanced an

alternative basis for refusing the input tax claim in relation to deal eight, which was that K Corp (upon whom the burden lay) had not satisfied the Tribunal that it had ever received a taxable supply from Hendon and that the invoice K Corp had received from Hendon did not contain a description of the goods sufficient to identify them for the purposes of a VAT input tax claim. We return to this point at [164].

149. In relation to knowledge or means of knowledge, HMRC submitted that K Corp, through Mr Kandanchani, was aware of the prevalence of MTIC fraud in the industry in which he operated prior to February 2006. The evidence showed that the need for him to conduct due diligence checks on his trading partners was brought to his attention at two meetings in 2005 and that K Corp was sent the "Redhill" letter (warning it of the need to verify VAT numbers of commercial partners) in August 2005. K Corp was also issued with Public Notice 726 on Joint and Several Liability in September 2005. None of this was disputed and K Corp's counsel accepted that his client had a "general" level of awareness of MTIC fraud. HMRC also relied upon the fact that K Corp had been put through an extended verification procedure in the summer and autumn of 2005, such that it would be reasonable to assume that Mr Kandanchani was aware of the need to keep detailed records of transactions when making VAT input tax claims.

First Appellant

150. Mr Young's closing submissions were in summary that (i) there was not a level playing field between the Appellants and the Respondent as a result of HMRC's superior resources; (ii) the changed evidence of Mr Kandanchani was explicable in terms of his lack of resources with which to prepare his appeal and should not be presumed to be due to a lack of credibility; (iii) HMRC had failed to show that, on the basis of objective evidence, K Corp knew or should have known that the deals were fraudulent.

151. Mr Young submitted that the evidence showed K Corp to be a victim of fraud whereas HMRC was not. Mr Kandanchani's case was that he had been duped into investing his inheritance in these transactions and this was possibly because he was able to provide the working capital for certain transactions.

152. Mr Young reminded the Tribunal that HMRC bears the burden of proof in relation to his client's knowledge or means of knowledge. He referred the Tribunal to the decision of Peter Gibson J in *Baden, Delvaux and Lecuit v. Société General pour Favoriser le Développement du Commerce et de l'Industrie en France S.A.* [1983] B.C.L.C. 325, cited with approval by Millet J (as he then was) in *Agip (Africa) Ltd v Jackson* [1990] Ch 265. The possible states of knowledge had been described by Peter Gibson J as: "*(i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest or reasonable man; and (v) knowledge of circumstances which would put an honest and reasonable man on inquiry*". In the *Baden* case, Peter Gibson J had gone on

to find that a person in category (ii) or (iii) will be taken to have actual knowledge while a person in categories (iv) or (v) has constructive knowledge only. Mr Young referred the Tribunal to Millet J's decision in the *Agip Africa* case, as follows:

> I gratefully adopt the classification but would warn against over refinement or too ready assumption that categories (iv) or (v) are necessarily cases of constructive knowledge only. The true distinction is between honest and dishonesty. It is essentially a jury question. If a man does not draw the obvious inferences or make the obvious enquiries, the question is: why not? If it is because, however foolishly, he did not suspect wrongdoing or, having suspected it, had his suspicions allayed, however unreasonably, that is one thing. But if he did suspect wrongdoing yet failed to make inquiries because he 'did not want to know' (category (iii)), that is quite another. Such conduct is dishonest, and those who are guilty of it cannot complain if, for the purpose of civil liberty, they are treated as if they had actual knowledge".

153. Mr Young submitted that HMRC had not been able to impute actual knowledge to Mr Kandanchani and that "constructive knowledge" (categories (iv) and (v) in the extract above) was an insufficient basis on which to dismiss the appeal. He further submitted that HMRC's own knowledge of MTIC fraud had developed over a period of time and that it could not impute a sophisticated knowledge of all the relevant features to Mr Kandanchani in retrospect when it had not known them itself at the relevant time. We deal with this submission at [181].

154. Mr Young additionally submitted that Hendon had been permitted to reclaim input tax in relation to transactions in which K Corp had been refused the input tax claim and that it was inappropriate of HMRC to take inconsistent approaches to the same transaction. The Tribunal notes that it is not seized of any decision of HMRC's except for those under appeal and that, even if consistency of approach is a relevant issue for this Tribunal, it is unable to form a judgment in relation to decisions which are not before it.

155. As noted above, Mr Young had not complied with the Tribunal's direction to provide it and the other parties with his closing submissions in advance of the final hearing. In the written submission produced on the day of the hearing itself (therefore not previously seen by the other parties or the Tribunal) he had included a passage of fresh evidence from Mr Kandanchani that had not been served as a witness statement. This sought to provide explanations for some inconsistencies in his sworn testimony and referred to a new document obtained from Dubai which neither the Tribunal nor the other parties had seen and was not produced in evidence. The Tribunal explained to Mr Young that he could not introduce new evidence in his closing submissions. Mr Young informed the Tribunal that he made this submission "on instructions" and was not surprised by the Tribunal's response. After a brief private consultation with Mr Kandanchani Mr Young stated that an application to admit fresh evidence had been filed with the Tribunal and served on the other parties by his instructing solicitors and that

Mr Kandanchani had a copy of the relevant e mail on his Blackberry. Neither the Tribunal nor any of the representatives had received such an e mail and the Tribunal concluded that the application had not actually been made. Mr Young then made an oral application to introduce the fresh evidence contained in his written submission which was refused by the Tribunal. The Tribunal notes that the additional evidence consisted of explanations for his earlier evidence which Mr Kandanchani might properly have given in re-examination.

Second Appellant

156. The Second Appellant's argument was that, in relation to deal fourteen, there was no evidence that the VAT loss had been occasioned by fraud. He relied upon the decision of a differently constituted panel of the First-tier Tribunal (Tax) in the appeal of *My Secrets Limited v HMRC* [2011] UKFTT 72, in which the Tribunal heard that V2's FCIB bank account had been frozen, but that its accountant had previously asserted that the funds to meet its VAT liability were on deposit and could be made available to HMRC. The Tribunal in that appeal concluded that there was insufficient evidence of fraudulent evasion of VAT as it could not come to the conclusion that the VAT would never had been paid had the account not been frozen.

157. Mr Holland accepted that this Tribunal was not bound to follow the Tribunal's conclusion in that appeal. We heard evidence about V2 in this appeal which was not before the Tribunal in *My Secrets* and he accepted that we must reach our own conclusions on the totality of the evidence before us.

158. Mr Holland submitted that it was disappointing that a serious allegation against Mr Hussain (that he had duped Mr Kandanchani into participating in the deals) was made for the first time when Mr Kandanchani gave evidence. He pointed out that no warning had been given of the allegation in a witness statement or skeleton argument and that no evidence had been produced in support of it. He submitted that it was an inherently unlikely scenario given that Hendon had made significantly less profit in the deals than K Corp.

159. Mr Holland also submitted that the Tribunal ought not to accord to Mr Fletcher's evidence the weight of an expert opinion because he had not complied with the formal requirements for the evidence of an expert witness. He referred us to decisions of differently comprised panels of the First-tier Tribunal (Tax) which had excluded or rejected Mr Fletcher's evidence, whilst accepting that we were not bound to follow them. Mr Young had not objected to Mr Fletcher's evidence on behalf of his client, but asserted (as he had in cross examination of Mr Fletcher) that its impact was limited in view of the fact that his expertise was in relation to the European and not the global grey market in mobile phones. We deal with these submissions at [178] below.

The Tribunal's Conclusions

160. In reaching our conclusions we remind ourselves of the issues set out at [13] above and of the burden and standard of proof that we are to apply.

161. The evidence relied upon by HMRC in support of its case that the deals were orchestrated was largely undisputed. We are satisfied, on the basis of the totality of the evidence described at [21] above, that the fourteen deals in these appeals were orchestrated and that they were connected to the fraudulent evasion of VAT.

162. We have noted in particular that certain objective features, indicative of orchestration, were clearly within the knowledge of the directors of the Appellant companies. These were (looking at the overall pattern of trading): the fortuitously large deals arranged with new customers; the commissioning of inspection reports prior to the date of the deal; the shipment of valuable goods prior to the assumption of legal rights in relation to them; the extension of significant credit along the chain to and from traders without sound credit ratings; the consistent profit margins on what are said to be volatile commodities; and the prevalent inattention to standard contractual terms without any evidence of agreed contractual variation. We have additionally noted that the invoices issued by K Corp and Hendon themselves included sparse detail of the phones to be traded in what is known to be a fast-moving and consumer-driven marketplace where certain types of phones may be more in demand than others. The lack of detail in the invoices and in some inspection reports is all the more surprising given the absence of evidence that either Appellant Company director ever saw the goods in question and would therefore have had to place a high level of reliance upon the documentation. These factors are relevant to the Appellant companies' state of knowledge, considered below.

163. We also conclude that the evidence from the FCIB records, the incidences of circularity of goods and funds, the shared IP details and the large market share of particular phones involved in certain deals are factors which are also strongly indicative of orchestration. However, we find that there is no evidence of these factors being known to the Appellant companies' directors at the relevant time.

164. In relation to deals three and eight, we are satisfied on the balance of probabilities that firstly, the inspection reports were commissioned by K Corp two days before the deals were done. Secondly, we are satisfied that the parties in the chain had knowledge of the short shipment at the time that it occurred but nevertheless made payment for the full consignment of phones in the face of that knowledge. Thirdly, we are satisfied that Mr Kandanchani arranged for the phones to be shipped out of the country before K Corp had acquired ownership of them and fourthly that Medius paid K Corp for the full shipment, knowing that it was short and accepting a credit note for several months in lieu of the balance of goods due. Whilst there is perhaps insufficient evidence of the existence of the phones in deal eight to satisfy us beyond reasonable doubt that they existed, we conclude that there is evidence upon which we may properly conclude that they existed on the balance of probabilities. We take into account the documentary

evidence generated by those inspecting and shipping the phones (see [82] above), in addition to the documentary evidence that the parties generated. Having reached this conclusion, we do not need to consider HMRC's alternative basis for refusing the input tax in deal eight.

5 165. We now consider whether the Appellant companies had sufficient information from which to conclude that the only reasonable explanation for the deals was that they were connected with fraud. HMRC submitted that the factors described at [162] above fly in the face of any sensible commercial practice by leaving each party in the chain knowingly exposed to an extraordinary level of 10 commercial risk so that the only reasonable explanation must have been that they were directed for the purpose of fraud. Mr Holland submitted that the level of risk routinely involved in certain business practices was a matter in respect of which HMRC was obliged to call expert evidence. We reject this argument and conclude that it is open to us to form a view of what are reasonable and 15 unreasonable levels of commercial risk, based upon our own experience and common sense.

166. In considering the submission that fraud was the only reasonable explanation for the factors at [162], we must consider carefully the evidence of the Appellant companies' directors as to their own state of mind and business 20 practices. Having done so, we find that the level of risk involved in all the deals would be unacceptable to the normal business person trading at arms' length. We reject the alternative explanations given to us by Mr Kandanchani and Mr Hussain as lacking credibility. It follows that, when taken together with the directors' respective knowledge of MTIC fraud, we conclude that the companies 25 had the means of knowing that the deals were fraudulent. We conclude that it was the only reasonable conclusion the directors could have reached.

167. This is particularly the case in relation to deal three, involving as it did payment being made up the chain for a deficient quantity of goods. We find that payment was made for 2000 phones by K Corp and Hendon after they knew that 30 2000 phones were not present. We are also satisfied on the basis of the evidence provided by HMRC that deal eight was a concocted transaction designed to discharge the credit notes issued in relation to the short shipment. We make this finding based on the totality of the evidence, including the fact that the phones were ultimately sold at a price which discharged the credit notes. This seems to 35 us to be an unlikely coincidence in what was described to the Tribunal as a volatile market. Whilst acknowledging that the burden of proof lies with HMRC, the Tribunal notes that Mr Kandanchani had already given HMRC two mutually inconsistent explanations for deal eight and we did not accept the further explanation that he gave to the Tribunal in his oral evidence which in turn 40 amended the evidence given in his written witness statement.

168. Mr Kandanchani was shown clearly to have lied to the Tribunal whilst giving his evidence, in relation to his accommodation arrangements. The Tribunal regrets that in consequence of what it found to be untruthful testimony, it finds itself unable to rely upon Mr Kandanchani as a witness of truth. He was cross

examined on the basis that he was not a truthful man and we found this to be the case.

169. The Tribunal did not accept the explanation given by Mr Kandanchani for making significant amendments to his witness statement whilst in the witness box. We did not find it credible that a man of his intelligence would have signed a witness statement that was (as he said) so very erroneous, or that his former solicitors would have "manufactured" a witness statement so at odds with their client's instructions. That was a very serious allegation, but whilst Mr Kandanchani has since changed his solicitors, we heard no evidence about him having made a professional conduct complaint against Dass Solicitors (which no longer represented him but continued to represent Mr Hussain in these proceedings). We note that the relevant witness statement had been made in 2010 but that Mr Kandanchani only sought to amend it at the hearing in 2012, after he had heard HMRC's opening submissions and its evidence.

170. Although this was of course Mr Kandanchani's own appeal and significant personal funds were at stake, the Tribunal notes that K Corp was unable to assert the precise nature of its case until Mr Kandanchani gave evidence. The skeleton argument provided by his counsel, and his opening, were both opaque. Key details of the case, which emerged only during Mr Kandanchani's oral evidence, had not previously been made known to his own solicitors, to HMRC or to the Tribunal, and new documents were produced from his laptop which even his own representatives had not previously seen. His witness statement was amended during his testimony, as noted above. His theory about having been tricked into making the deals by Hendon was advanced for the first time in re-examination. Finally, he sought through his counsel to introduce fresh evidence at the closing submissions stage of the proceedings (for which permission was refused by the Tribunal) – see [155] above. Mr Young's explanation for these unusual features of his client's appeal was that his client had been without funds to instruct his solicitors and so could not prepare his appeal properly. He asked the Tribunal to consider the disparity of resources as between the Appellants and HMRC in this case.

171. Taking all those factors into account, the Tribunal notes that Mr Kandanchani is an intelligent and educated man and that this appeal concerned £1.5 million of his own money. In the circumstances we find that the changing nature of his case during the course of the appeal was indicative only of an inventiveness designed to provide an answer to HMRC's case. This finding serves to support our conclusion that Mr Kandanchani could not be relied upon as a witness of truth.

172. It was a significant feature of the transactions between these Appellants that almost no contemporaneous paperwork, such as contracts or correspondence, had been created or retained by the parties to the deals. Mr Kandanchani told the Tribunal that he had made contemporaneous notes in a notebook which he had subsequently mislaid. He said he had not produced the notebook to HMRC at the time of its enquiries because he had never been asked for it. We found it frankly

incredible that his records of discussions with Mr Hussain and others had not been meticulously kept and retained, in view not only of his professional and educational background but also his own experience of HMRC's extended verification process the previous year (in respect of which he had kept detailed notes and written frequently to HMRC). Mr Kandanchani also accepted that he had a general knowledge of MTIC fraud and the need for due diligence. Last but not least, we take into account the value of the trades in which he was engaged (he told the Tribunal that he had used his inheritance to finance this business) and the unlikelihood (as we find) of him keeping no records or having carelessly mislaid them of these financially significant endeavours. We conclude that there was no need for Mr Kandanchani to keep notes of his trades with Mr Hussain because they were not arms' length transactions but ones directed by a third party. We conclude that there was ample evidence before him from which Mr Kandanchani could have concluded that the only reasonable explanation for the deals he was being offered was that they were connected with MTIC fraud.

173. Mr Hussain's case, by contrast, was that he was an unsophisticated man when it came to business and that he had relied too heavily on others and not realised the danger he was in. Mr Husain was cross examined on the basis that he was not a truthful witness. It was suggested to him by HMRC's counsel that he had chosen to affirm despite being a devout Muslim, so that he could lie to the Tribunal. He denied this.

174. Mr Hussain was unable to explain satisfactorily how he came to be involved in the deals, and in particular, how Hendon came to switch roles with K Corp in deal fourteen. Like Mr Kandanchani, Mr Hussain produced new documents during the course of his evidence, which had not previously been seen by his representative or by HMRC. It was initially suggested by HMRC's counsel that certain of these had been forged, but this allegation was subsequently withdrawn and we take no account of it. Mr Hussain's credibility was nevertheless attacked by HMRC in relation to his inaccurate VAT returns.

175. The Tribunal was not satisfied that Mr Hussain had lied to it about his business accounts and VAT returns, as was suggested to him. We gained the impression not of an untruthful witness but of someone who was, as he claimed, inept and inexperienced at business. However, we do not accept that his naïve approach exonerated him from responsibility for the involvement of his business in these fraudulent transactions. We conclude that the repeated evidence of his ineptitude (for example, his inability to explain the issuing of multiple invoices in deal eight, the confusion about his inaccurate VAT returns and accounts) was a convenient smoke screen behind which he tried to hide the fact that there was no reasonable explanation for the deals other than that they were orchestrated. This is perhaps most readily demonstrated by Hendon's change of position from buffer to broker in deal fourteen, which significantly improved the financial position of the company but for which Mr Hussain had no explanation. We conclude that there was ample evidence before Mr Hussain from which even he could have concluded that the only explanation for the deals in which he was involved was that they were fraudulent.

176. By the time they had finished their evidence, the directors had both suggested (for the very first time) that they had been duped into taking part in fraudulent transactions. Mr Kandanchani suggested that he had been tricked by Mr Hussain. Mr Hussain later asserted that "someone" had taken advantage of his own lack of business knowledge. Neither was able to put forward an explanation or indeed any evidential basis for concluding that someone wanted to dupe them into participation in the deals and neither did they satisfactorily explain why this allegation had not been raised before they gave their oral evidence. We had some sympathy with Mr Holland's complaint that Mr Kandanchani's allegation should not have come as a surprise to himself and his client at a late stage in the proceedings. We accept that, had the nature of Mr Kandanchani's case been made clear in advance of the hearing, it may well be that Mr Holland would have applied for the appeals to be severed. He would have undoubtedly chosen to have cross examined Mr Kandanchani on the point. However, as we conclude that there is no basis upon which we could find that either director was the victim of fraud, we are satisfied that neither Appellant company's appeal was in the event prejudiced by the late appearance of these allegations.

177. We are satisfied on the balance of probabilities that deal fourteen involved the fraudulent evasion of tax liability by V2 and that Hendon was connected to this fraud. We are not bound by the findings of a different Tribunal in the *My Secrets* case and we had the advantage of being able to consider the additional evidence about V2, produced by HMRC, and relating to the presentation of a winding up petition, the appointment of a liquidator and the making of a freezing order in the High Court. We accept Officer Smith's evidence that V2 had been engaged in prolific MTIC fraud and the assessment of the High Court that there were grounds to make the freezing order. The High Court relied upon the affidavit of Ms Cox, which was produced to us. We have no basis for assessing the credibility of the hearsay assertions of V2's accountant that there was an intention to pay the VAT due which was frustrated by the order, but we must view his reported comments in the context of our knowledge of a fraudulent scheme of operation by that company. Accordingly, we reject Mr Holland's submissions in relation to V2 and go on to find that HMRC's loss was occasioned by fraud and that Mr Hussain had the means of knowledge that the deal was fraudulent for the reasons given above.

178. As also noted above, we heard objections to the evidence of Mr Fletcher. In admitting it, we noted that the Tribunal's procedural rules make clear that the formal rules of evidence do not apply in proceedings before it. We found Mr Fletcher's evidence useful in allowing us to form a background picture of the grey market in mobile phones in Europe, but we did not rely on it in reaching our conclusions as to Mr Kandanchani and Mr Hussain's respective states of knowledge of the objective factors indicating fraud in their own deals.

179. As noted above, we are satisfied on the evidence that the characteristics of the fourteen deals are strongly supportive of orchestration. We accept HMRC's submission that for an MTIC fraud to be successful, the transactions must be

directed. In the absence of any alternative reasonable explanation from either Appellant company director as to how they came to be involved in all these fraudulent transactions on all of these occasions, and on the basis that the risk of MTIC fraud had been specifically brought to both directors' attention, we have no hesitation in concluding that Mr Kandanchani and Mr Hussain had the means to conclude that the transactions in which they were involved were contrived, and that they were connected to fraud. The weight of evidence within their respective knowledge in relation to each of the deals in which they participated leads us to conclude that there was no other reasonable explanation open to them for the transactions in which they were each involved, not least because they departed so far from sensible commercial practice for companies of the limited resources of K Corp and Hendon.

180. In so concluding, we have applied the *Kittel* test as explained in *Mobilx.* We do not accept the submission that *Mobilx* is now to be regarded as bad law in the light of *Mahagében.* Mr Holland was unable to produce any authority for his submission to this effect. HMRC submitted that the *Mahagében* decision had not broken any new ground, nor had it been intended to, as it was a preliminary ruling without the benefit of a written opinion from the Advocate General, and turned on the facts of the cases considered. We accept HMRC's submission.

181. Mr Young's submissions as to the domestic law on actual/constructive knowledge represented, in our view, an attempt to over-refine the *Kittel* test which the decision in *Mobilx* expressly warns us against. Mr Young's argument to this effect was produced at the closing submissions stage and without the prior notice that HMRC would have had if he had complied with the Tribunal's directions, so it was difficult for HMRC to respond to it. We note that the case law he cited was concerned with liability to account as a constructive trustee and so involved a different exercise from the one we are engaged in here. We reject his submissions in favour of applying the *Kittel* test, without over-refinement.

182. Accordingly, both these appeals are now dismissed.

183. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ALISON MCKENNA
TRIBUNAL JUDGE

RELEASE DATE: 22 July 2013