Appeal number: LON/2008/1178

VAT – input tax – MTIC fraud – whether appellant knew its transactions were connected to fraudulent evasion of VAT – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

EXPEDITORS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS
JOHN ROBINSON

Sitting in public at the Royal Courts of Justice on 16-27 May 2016 and having considered written closing submissions delivered on 16 June 2016, 10 October 2016 and 17 October 2016

Fred Howarth for the Appellant

Jenny Goldring and Howard Watkinson, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by Expeditors Limited ("Expeditors") against the decision of HMRC dated 19 May 2008 denying it the ability to deduct input tax of £346,669.49 that it claimed in its 05/06 VAT accounting period. The grounds for HMRC's decision were that Expeditors' transactions in relation to which the claim for input tax arose were connected with the fraudulent evasion of VAT and that Expeditors knew, or should have known, of this connection. Prior to the hearing, and in its written closing submissions, Expeditors conceded that its transactions were connected with fraudulent evasion of VAT but maintained that it did not know, and did not have the means of knowing, that this was the case.

2. Thus, this appeal relates to an allegation of Missing Trader Intra-Community ("MTIC") fraud. Since there have now been a large number of appeals to the Tribunal relating to MTIC fraud, we will not provide our own description of the nature of the fraud, or explain certain terms used in connection with MTIC fraud. Rather, we would refer the interested reader to paragraphs 1 to 3 of the judgment of *Roth J in POWA (Jersey) Ltd v HMRC* [2012] UKUT 50 (TCC). Throughout this decision, we will use terms commonly used in connection with MTIC fraud (for example the terms "defaulter", "buffer" and "broker"). However, in using these terms we are not pre-judging the question of whether Expeditors knew, or should have known, that its transactions were connected with fraud and are simply adopting a convenient shorthand. The substance of our conclusion on Expeditors' knowledge or means of knowledge is set out in Part III of this decision.

3. This appeal relates to the basic version of MTIC fraud. The transactions that result in Expeditors' claim for input tax can be traced back directly to a default by a trader earlier on in the chain and the appeal does not, therefore, involve any contra-trading.

Evidence

The witnesses who gave evidence

4. HMRC relied on witness statements made by the following witnesses. We have indicated with an asterisk which witnesses were cross-examined by Mr Howarth:

(1) Christopher John Cartner[1]

(2) David John Berry*

(3) Gordon Murray Fyffe

(4) Sally Ellen Medcroft

(5) Martin Russell William Evans

[1] Officer Cartner retired from HMRC prior to the hearing. His evidence as "broker officer" for Expeditors was, accordingly, adopted and supplemented by Officer Berry.

(6) Timothy Reardon

(7) Roderick Guy Stone*

(8) Gavin William John Stock*

(9) Andrew Letherby

(10) Richard David John Meynell

(11) Paul Christopher*

(12) Terence Mendes*

(13) Sue Ogburn*

(14) Nigel Saunders

(15) Antony Bradshaw*

(16) Matthew Peter Corkery*

(17) Barry Michael Patterson

5. Of HMRC's witnesses, Officer Letherby gave expert evidence on various computing matters, principally relating to information contained on servers of the First Curacao International Bank ("FCIB"). Mr Corkery, a partner at Ernst & Young, gave expert evidence on certain economic matters concerned with the trade in mobile phone handsets. There was no challenge to Mr Corkery's status as an independent expert and we have accepted that he is qualified to give expert evidence. However, even though no particular expertise was claimed for HMRC's other witnesses, a number of their witness statements contained large amounts of inadmissible opinion evidence. The reasons for that were understandable, if not entirely excusable: HMRC's case in this appeal in large part involves requesting the Tribunal to make inferences as to Expeditors' knowledge or means of knowledge from particular facts. Therefore, as well as setting out evidence as to the facts upon which HMRC relied, a number of HMRC officers felt the need to supplement that evidence with statements as to why, in that officer's view, the facts supported the conclusion that Expeditors knew, or should have known, that its transactions were connected with fraud. Mr Howarth did not himself take a point on this issue. We considered that it would be disproportionate to adjourn the hearing to require HMRC to remove all such inadmissible evidence from their witness statements (and are reassured to note that Judge Berner and Judge Walters QC formed a similar view in *Megantic Services Ltd v HMRC* [2013] UKFTT 492). However, we made it clear to Mr Howarth that he did not need to challenge inadmissible opinion evidence in cross-examination and we have ourselves taken care to exclude such evidence from our own deliberations whether or not it was so challenged.

6. Expeditors relied on a witness statement of William Robert Howard who was, at all material times, its sole director and Ms Goldring cross-examined him. During the hearing, Mr Howard was suffering from an over-secretion of stomach acids which caused him to experience periods of nausea. Before he was due to give evidence, he consulted a doctor who prescribed medication which appeared to alleviate the worst of the symptoms. We asked Mr Howard if there were any adjustments that we should

make in order to make the process of cross-examination as painless as possible, for example whether we should schedule regular and frequent breaks. Mr Howard felt able to proceed without any such adjustments but agreed to keep the Tribunal informed if he did experience problems at any point. In fact he coped well with the rigours of cross-examination. His only request was to be allowed to drink coffee at one point during his cross-examination as his medication was causing him some drowsiness and we were perfectly happy to accommodate that request.

7. The evidence we saw referred to a large number of companies and individuals. A short list of the key companies involved, and the defined terms we use to identify them, is contained in the Appendix to this decision.

8. Finally, in its written closing submissions, Expeditors referred to several documents that had not previously been put in evidence and subsequently made an application to adduce those documents, and a further witness statement from Mr Howard. We refused that application and have separately given reasons for doing so.

Our conclusions on the honesty and veracity of the witnesses

9. We found all of HMRC's witnesses to be reliable and honest witnesses.

10. We were not satisfied that Mr Howard was a reliable witness. Later in this decision we will give examples of specific instances where we found Mr Howard's evidence to be either untrue, implausible or less than candid and where we have preferred the evidence of other witnesses.

Structure of this decision

11. As we have noted, HMRC's case in this appeal is that it is possible to infer from a number of primary facts that Expeditors either knew, or should have known, that its transactions were connected with fraudulent evasion of VAT. Expeditors disputes a number of the primary facts on which HMRC rely and, more generally, disputes that HMRC have discharged their burden of proving knowledge or means of knowledge. In those circumstances, we will order this decision as follows:

(1) In Part I of this decision, we will set out our findings of primary fact grouped under various thematic headings as to the nature of Expeditors' business, the transactions it undertook and how it undertook them. The focus in Part I will, accordingly, be on setting out what the primary facts are.

(2) In Part II we will set out our understanding of the applicable law.

(3) In Part III we will consider whether, in the light of the primary facts that we have found, and taking into account the submissions of the parties, HMRC have satisfied their burden of proof. That will, in large part, involve deciding whether, in the light of the facts we have found in Part I, Expeditors either knew, or should have known, that the transactions in question were connected with fraudulent evasion of VAT.

PART I – FINDINGS OF PRIMARY FACT

The formation of Expeditors and its early transactions

Mr Howard's previous role at Unique

12. Expeditors was incorporated on 21 December 2004. At all material times, Mr Howard was the sole director of Expeditors and the only person with any material input into the conduct of Expeditors' business. We considered Mr Howard to be an obviously intelligent man and he holds a university degree. He clearly has a deep knowledge of the market in mobile phone handsets.

13. Prior to establishing Expeditors, Mr Howard had worked at Unique Distribution Limited ("Unique") which carried on a business that involved trading in mobile phones. Mr Howard progressed to being Head of Trading at Unique.

14. In August 2004, Mr Howard left Unique following a dispute. Although not directly relevant to the question of Expeditors' entitlement to input tax recovery, the nature of that dispute and Mr Howard's explanation of it, is relevant to his credibility as a witness and we will, therefore, deal with it in more detail than would otherwise be necessary.

15. On 25 May 2005, Officers Paul Christopher and Tracy Marsh made a "post registration" visit to Expeditors' premises and spoke to Mr Howard. Officer Christopher made a note of that conversation which included the following sentence:

> Mr Howard states that he left Unique in August 2004 and advised that his departure was due to another colleague attempting to poach a deal and undercut him on price.

16. In his oral evidence at the Tribunal Mr Howard gave a somewhat different account of his departure from Unique. He said that he had been involved in a very successful transaction that had generated £250,000 of profit for Unique and £1m of working capital. However, because of a loss elsewhere in the organisation, none of the profit generated by the deal was used to pay bonuses to staff involved. In his words:

> The money generated by the trading department was to offset the loss that was made in a different part of the business. As we weren't informed before we did the trades I found that beyond the pale and decided to leave immediately.

17. Ms Goldring cross-examined Mr Howard on the apparent inconsistency. Mr Howard did not suggest that Officer Christopher had simply misunderstood the explanation he had given. Rather, he insisted that the explanations set out at [15] and [16] were in fact entirely consistent and that the managing director of Unique (who made the decision not to pay a bonus) was the "colleague" who had "poached" the deal by allocating the profits it generated to a loss made elsewhere in the business. That explanation was, perhaps, plausible but failed to explain how this action amounted to Mr Howard being "undercut on price". When pressed on this in cross-examination, Mr Howard said that this did amount to "undercutting" as:

> The deal's been removed. You are undercut. You're getting nothing for all of the work you've done.

18. We found Mr Howard's explanation in this regard wholly unconvincing. Unique's decision not to pay a bonus cannot fairly be described as poaching a deal and "undercutting on price". While Mr Howard's precise reasons for leaving Unique are not relevant to Expeditors' claim for input tax recovery, the exchange set out above suggested to us that Mr Howard was not giving straightforward evidence even on a point of little direct relevance. That did not leave us with a favourable impression as to the reliability of his evidence on disputed matters of central importance. That impression was reinforced by other instances, referred to elsewhere in this decision where we found Mr Howard's evidence to be less than candid or evasive.

19. Whatever the precise reasons why Mr Howard left Unique, we have accepted Mr Howard's evidence that he based a large part of his business practice at Expeditors, including the process that he followed, and the documents that he used, on experience he had gained at Unique. In addition, a number of the counterparties with whom Expeditors traded were counterparties that Mr Howard came to know during his time at Unique.

Expeditors' registration for VAT

20. Mr Howard applied for Expeditors to be registered for VAT purposes. In support of that application, Mr Howard sent letters of introduction from two different companies based in Dubai – Eurolink Trading LLC and Impex Electronics. The wording of those letters was strikingly similar. Ms Goldring suggested that these two letters appear to have been faxed shortly after each other from the same place (suggesting that the companies providing the references were somehow linked). However, the fax header on the documents appears to be Mr Howard's header which suggests that it was Mr Howard who faxed one document shortly after the other. That is not perhaps surprising as Mr Howard was sending both letters to HMRC in support of Expeditors' application for VAT registration.

21. Expeditors' application to be registered for VAT purposes was successful and it was duly registered for VAT purposes. From May 2005, it had monthly VAT accounting periods.

Expeditors' general awareness of MTIC fraud

22. As noted at [15], Officers Christopher and Marsh visited Expeditors' premises on 25 May 2005, over a year before the transactions with which this appeal is concerned. During that visit, the HMRC officers discussed MTIC fraud with Mr Howard and handed him a copy of Notice 726 (which contained information relevant to businesses transacting in goods that were at risk of being used in MTIC fraud). We are satisfied that the information that was imparted during this visit, subsequent updates that HMRC provided and Mr Howard's own considerable experience in the mobile phone industry would have made it clear to Expeditors from an early stage in its history that, to use Ms Goldring's expression, the industry of dealing wholesale in mobile phones was "rife with fraud". Mr Howard accepted in cross-examination that he realised

from 2005 onwards that significant amounts of money were being "haemorrhaged" in the mobile phone industry through MTIC fraud.

Expeditors' early commission deals

23. Expeditors has not always traded as principal by acquiring mobile phones and selling them at a higher price. Mr Howard explained this in his witness statement as:

> The first trades Expeditors made were locating stock for a customer and brokering the deal on a commission only basis. The actual transaction was completed by two companies I introduced to each other and the company was paid a small commission.

24. For example, in February and March 2005, Expeditors issued commission invoices to 3G Mobile Phones Ltd ("3G"). An example narrative on such invoices was "Relates to 2000@£1 from LTL" which was explained as meaning that 3G had purchased 2,000 mobile phones from LTL Communications Ltd ("LTL") and that Expeditors was to receive a commission of £1 per phone for assisting in putting together that deal. On 25 May 2005, Expeditors similarly issued 3G with invoices for commission on purchases from "STN" (which we took to be a reference to Secure Trader Network Ltd).

25. However, 3G already knew both LTL and STN. In November and December 2004, 3G and STN had entered into mobile phone transactions worth over £1m with each other. In December 2004, LTL and 3G entered into transactions worth £637,437.50 with each other. Therefore, Expeditors was receiving commission for deals between two parties who knew each other well.

26. In cross-examination, Ms Goldring pressed Mr Howard on why two companies that knew each other well would pay Expeditors commission to broker a deal between them. Mr Howard's explanation was that everything depended on the ability to locate stock of the right specification and, if Mr Howard was on the phone to LTL for example and realised during that call that LTL had stock that 3G wished to purchase, 3G would not be able to get through to LTL if they had called directly. Therefore, Mr Howard's strategy in such cases was to keep LTL on the phone and call 3G to tell 3G that he had found stock matching 3G's requirements but that he would expect a commission for doing this. Partly because of Mr Corkery's evidence (which we refer to at [136]) that in the "grey market" in mobile telephones, there would be a strong incentive to "disintermediate" market participants, and partly because we regarded it as inherently implausible that a business person would pay commission to a third party simply because it could not get through on the telephone to a vendor, we have not accepted this explanation. Therefore, while we are satisfied that Expeditors did actually receive commission from 3G relating to these deals, we are not satisfied that there was a genuine commercial justification for 3G to pay that commission.

Significant increase in Expeditors' turnover

27. Expeditors' first "broker" transaction was in April 2005 when it sold a consignment of mobile phones to a company incorporated in Dubai. From then on,

Expeditors did not trade in mobile phones every month (partly because Mr Howard suffered from poor health). Nevertheless, its turnover increased significantly over a short period of time. On 22 transactions that were effected in just 13 days between February and May 2006, Expeditors' turnover was in excess of £5 million.

The deal chains relevant to this appeal

28. Expeditors has been denied the right to recover input tax associated with 10 purchases of quantities of mobile phones that it made in its 05/06 VAT accounting period. HMRC have traced the chain of supply of those mobile phones backwards by identifying, from invoices and other documentation, the identity of the person supplying the phones to Expeditors, that supplier's own supplier and so on. HMRC have also, in many cases, been able to trace the chain of supply forward by identifying Expeditors' own customer, then its customer's customer and so on. Expeditors accepted that the deal chains that HMRC constructed using this process accurately reflected the transactions that took place.

Deal 1

29. Deal 1 involved 2,000 Nokia 6681 handsets. A UK company, Computec Solutions Limited ("Computec") first acquired those handsets from Megatek Sarl ("Megatek"), a company incorporated in France. Those handsets then passed through five buffer traders (Phones 121 Ltd, A2Z Trading Ltd, NTS Telecom Ltd, Reya Ltd and Tracker Trading Ltd) before being acquired by LTL who sold the handsets to Expeditors.

30. The buffer traders made mark-ups of a round number of pence per handset. In the interests of brevity, we will not set out all of the mark-ups in all of the deal chains. However in Deal 1, Phones 121 Ltd and A2Z Trading Ltd, both made a mark-up of 20 pence per phone, NTS Telecom Ltd made a mark-up of £1 per phone, Reya Ltd made a mark-up of £1.50 per phone, Tracker Trading Ltd made a mark-up of 50 pence per phone and LTL made a mark-up of £1 per phone.

31. Expeditors sold the handsets to Blue Star Telecom APS ("Blue Star"), a company incorporated in Denmark for a mark-up of £11 per phone (equal to 7% of the VAT-exclusive purchase price that Expeditors paid LTL) and, on 5 May 2006, Expeditors issued Blue Star with an invoice numbered 74. Blue Star in turn sold the handsets to Megatek who, as noted at [29], had owned them previously.

32. The parties agreed that Computec fraudulently evaded its obligation to pay HMRC the VAT due on its supply of the phones to Phones 121 Ltd.

Deals 2 and 3

33. Deals 2 and 3 involved 1,000 Nokia N70 and 500 Nokia 6111 handsets. A UK company, Bullfinch Systems Ltd ("Bullfinch"), first acquired those handsets from Megatek. Those handsets then passed through a number of buffer traders (Data Solutions Northern Ltd, Star Express Ltd, NTS Telecom Ltd, Reya Ltd and Tracker Trading Ltd) before being acquired by LTL who sold the handsets to Expeditors.

34. The buffer traders made margins in round numbers of pence per mobile phone ranging from 20 pence to £1. LTL made a mark-up of £1.50 per phone on the Nokia N70s and of £1 per phone on the Nokia 6111s when it sold them to Expeditors.

35. Expeditors sold the handsets to Compucell BV, a company incorporated in the Netherlands for a mark-up of £13 per phone on the Nokia N70s (7% of Expeditors' VAT-exclusive purchase price) and a mark-up of £10 per phone on the Nokia 6111s (6.8% of Expeditors' VAT-exclusive purchase price). On 11 May 2006, Expeditors issued Compucell with an invoice numbered 75 (that dealt with the sale of both the Nokia 6111s and the Nokia N70s).

36. The parties agreed that Bullfinch fraudulently evaded its obligation to pay HMRC the VAT due on its supply of the phones to Data Solutions Northern Ltd.

Deals 4 and 5

37. Deals 4 and 5 involved 1,500 Nokia 7610s and 1,500 Nokia 6230i handsets. A UK company, Smart View Ltd ("Smart View"), first acquired those handsets from Megatek. Those handsets then passed through a number of buffer traders (World of Power Ltd, Star Express Ltd, NTS Telecom Ltd and Electronic Global Ltd) before being acquired by LTL who sold the handsets to Expeditors.

38. The buffer traders made margins in round numbers of pence per mobile phone ranging from 20 pence to £1. LTL made a mark-up of £1 per phone when it sold them to Expeditors.

39. Expeditors sold the handsets to Blue Star for a mark-up of £8 per phone on the Nokia 7610s (7% of Expeditors' VAT-exclusive purchase price) and a mark-up of £7.75 per phone on the Nokia 6230is (also 7% of Expeditors' VAT-exclusive purchase price). On 23 May 2006, Expeditors issued Blue Star with an invoice numbered 76 (that dealt with the sale of the Nokia 7610s and the Nokia 6230is).

40. The parties agreed that Smart View fraudulently evaded its obligation to pay HMRC the VAT due on its supply of the phones to World of Power Ltd.

Deal 6

41. Deal 6 involved 1,000 Nokia 9300i handsets. Smart View Ltd ("Smart View") first acquired those handsets from Megatek. Those handsets then passed through a number of buffer traders (World of Power Ltd, Star Express Ltd, NTS Telecom Ltd, Reya Ltd and Tracker Trading Ltd) before being acquired by LTL who sold the handsets to Expeditors.

42. The buffer traders made margins in round numbers of pence per mobile phone ranging from 20 pence to £1. LTL made a mark-up of £2 per phone when it sold them to Expeditors.

43. Expeditors sold the handsets to Blue Star for a mark-up of £19.50 per phone (7.1% of Expeditors' VAT-exclusive purchase price). On 23 May 2006, Expeditors issued Blue Star with an invoice numbered 77.

44. The parties agreed that Smart View fraudulently evaded its obligation to pay HMRC the VAT due on its supply of the phones to World of Power Ltd.

Deals 7 and 8

45. Deal 7 involved 549 Nokia 8800 and 500 Sony Ericsson W810i handsets. 3D Animations Ltd ("3D Animations") first acquired those handsets from Bon Bein Kom, a company incorporated in Belgium who had, in turn, acquired them from Sunico A/S ("Sunico"), a company incorporated in Denmark. Those handsets then passed through a number of buffer traders (Lagan (UK) Ltd, Jos (UK) Ltd, New Order Trading Ltd) before being acquired by Santok Enterprises Ltd ("Santok"), who sold the handsets to Expeditors.

46. The buffer traders made margins in round numbers of pence per mobile phone ranging from 35 pence to £1. Santok made a mark-up of £9.50 per phone on the Nokia 8800s, and £4 per phone on the Sony Ericsson W810is when it sold them to Expeditors.

47. Expeditors sold the handsets to Sunico for a mark-up of £24.50 per phone on the Nokia 8800s (6.9% of its VAT-exclusive purchase price) and £13.50 on the Sony Ericsson W810is (7.1% of its VAT-exclusive purchase price). As noted at [45], Sunico had owned the phones previously and, accordingly, Deals 7 and 8 were circular. On 30 May 2006, Expeditors issued Sunico with an invoice numbered 78 dealing with both the Nokia 8800s and the Sony Ericsson W810is.

48. The parties agreed that 3D Animations fraudulently evaded its obligation to pay HMRC the VAT due on its supply of the phones to Lagan (UK) Ltd.

49. HMRC have traced this deal forward. Sunico subsequently sold the phones to PLC Communications Ltd, a company incorporated in the UK. Thus the phones in Deal 7 came into the UK (when 3D Animations Ltd acquired them), left the UK (when Expeditors sold them to Sunico) and immediately came back into the UK (when Sunico sold them to PLC Communications Ltd).

Deal 9

50. Deal 9 involved 2,000 Samsung D600 handsets. The chain of transactions leading to Expeditors was identical to that in Deals 7 and 8: the phones started with Sunico who sold to Bon Bein Kom who sold to 3D Animations. The phones then passed through the same buffer traders in the same order. Santok then sold the phones to Expeditors. The buffer traders made the same mark-ups as they made in Deals 7 and 8. Santok made a mark-up of £3.50 per phone.

51. Expeditors sold the phones to Sunico for a mark-up of £10.50 per phone (equal to 6.9% of its VAT-exclusive purchase price). Since Sunico had owned the phones previously, the phones transferred in a circle beginning and ending with Sunico. On 31 May 2006, Expeditors issued Sunico with an invoice numbered 79. As with Deals 7 and 8, Sunico subsequently sold the phones to PLC Communications Ltd.

52. The parties agreed that 3D Communications fraudulently evaded its obligation to pay HMRC the VAT due on its supply of the phones Lagan (UK) Ltd.

Deal 10

53. Deal 10 involved 1,500 Nokia 6680 handsets. The chain of transactions leading to Expeditors was identical to that in Deals 7, 8 and 9. The phones started with Sunico, who sold to Bon Bein Kom who in turn sold them to 3D Animations. The phones then passed through the same buffer traders in the same order. Santok then sold the phones to Expeditors. The buffer traders made the same mark-ups as they made in Deals 7, 8 and 9. Santok made a mark-up of £2.50 per phone.

54. Expeditors sold the phones to Sunico for a mark-up of £9.25 per phone (equal to 6.9% of its VAT-exclusive purchase price). Since Sunico had owned the phones previously, the phones transferred in a circle beginning and ending with Sunico. On 31 May 2006, Expeditors issued Sunico with an invoice numbered 80.

55. The parties agreed that 3D Communications fraudulently evaded its obligation to pay HMRC the VAT due on its supply of the phones to Lagan (UK) Ltd.

Expeditors' overall profit from these 10 deals

56. The 10 deals that are the subject of this appeal took place over 5 days in May 2006. They generated a gross profit of £138,000 for Expeditors which was more than the £126,000 that Mr Howard estimated he earned (once bonuses were taken into account) for a year's work at Unique. That profit came from the mark-up that Expeditors charged when it sold phones to its customers which, as noted above, was in all 10 deals around 7% of the VAT-exclusive purchase price that Expeditors paid to acquire the phones.

Expeditors' business in overview

57. In this section, we will set out an outline of how Expeditors' business operated in overview. In the next section, we will set out some findings on particular aspects of that business.

58. Expeditors traded on a "back to back" basis. It sought to acquire phones from a supplier and sell the entirety of the phones so purchased to its own customer. Expeditors added no value to the phones with which it dealt. It simply made its profit by selling the phones for more than the price at which it acquired them. However, a complication was that Expeditors would typically purchase from a supplier based in the UK (who would have to account for VAT on its supply and who would therefore

charge Expeditors an amount in respect of VAT), but Expeditors would be making a zero-rated supply of the phones to a customer based outside the UK. Therefore, Expeditors needed to fund the difference between the higher (VAT inclusive) purchase price it had to pay to its supplier and the lower (VAT free) purchase price that it received from its own customer. As noted at [87] and [93], Expeditors borrowed money for this purpose (the "Loans").

59. Aside from the Loans, Expeditors had limited financial resources available to it. It was not a credit-worthy company. Mr Howard accepted in cross-examination that Expeditors had "zero" financial strength.

60. Mr Howard would spend most of his working day on the telephone or internet seeking to identify stock that he could purchase and immediately sell. He accepted that this information was readily available. Sometimes he would receive a request from a prospective customer requesting stock; sometimes he would realise that a particular supplier had stock for sale, in which case he would set about seeking to identify a customer. He recorded information on prices offered by suppliers on Daily Price Reference Sheets. Mr Howard stated that Expeditors' practice was not to purchase from suppliers offering the lowest price given the warnings that HMRC made in Notice 726.

61. It was crucial to Expeditors' business that it be offered a "ship on hold" facility by its supplier. Of the 40 or so potential suppliers that Mr Howard spoke to each day, only four suppliers (Santok, LTL, MNR Global and Crotek) offered Expeditors this facility. Under a "ship on hold" facility, Expeditors' supplier would deposit the goods to be sold to Expeditors at a particular freight forwarder. Before Expeditors had paid for the goods, the supplier would permit those goods to be shipped to an agreed location outside the UK (since, as noted at [58], Expeditors' customer would be located outside the UK) to enable Expeditors' proposed customer to inspect the goods in its home country. Under the terms of that arrangement, the goods could not move outside the control of the freight forwarder who would thereby retain a "hold" on the stock. If that inspection was satisfactory, the transaction would proceed. If it was not, Expeditors' supplier could instruct the freight forwarder to ship the goods back to the UK and Expeditors would be charged the expenses consequent on doing so.

62. Mr Howard stated that the benefit to Expeditors of the "ship on hold" arrangement was that it meant that Expeditors did not have to pay its supplier in full for the goods while there was still a risk of Expeditors' customer deciding that the outcome of the inspection was unsatisfactory and that it would not proceed with the purchase. We are satisfied that Expeditors did, as a matter of fact, implement these "ship on hold" arrangements in all of the deals at issue in this appeal. However, a number of points arising from "ship on hold" arrangements were disputed and we make further findings on this issue below.

63. Once Mr Howard had identified both a supplier willing to offer a "ship on hold" facility and a customer, he would fill in a "back to back authorisation form" that identified, inter alia, Expeditors' customer, its supplier, the purchase and sale price and the amount of VAT that Expeditors needed to fund. He would then move to close

the deal as soon as he could and would press his supplier to deliver the goods to a freight forwarder (typically Paul's Freight or Hawk Precision Logistics Ltd ("Hawk")) as soon as possible so that Expeditors would have a practical assurance that the transaction would progress. He would record the progress of the transaction, and the receipt of various confirmations and paperwork on a "back to back tracking and approval form".

64. Before he would transact with his supplier, he would request certain confirmations from HMRC's VAT office in Redhill. The scope of those confirmations was disputed and we make findings on this point below.

65. The effect and import of contractual and other documentation associated with Expeditors' sales and purchases was disputed, and we make findings on these issues below. However, in outline the relevant documentation surrounding the closing of a transaction was as follows:

(1) Expeditors' customer would send Expeditors a purchase order setting out, among other information, the type and quantity of stock being ordered. Typically the description of the phones would be brief. The make and model of the phones was always specified. Sometimes (typically in deals in which Blue Star was purchasing), it would be stipulated that the phones must be "SIM free original stock". In deals where Sunico was the purchaser, the requirement was typically for "Central European spec, Central European warranty, Western languages required".

(2) Expeditors would send its supplier a purchase order. That would typically describe the phones by reference to their manufacturer and model number. Expeditors' purchase order typically gave more information than was set out on its customer's purchase order, for example specifying the type of warranty required, that the phones must be "brand new product with latest version software" and must not be "previously SIM locked".

(3) Expeditors would send its customer (who was either Blue Star, Compucell or Sunico in each of the deals relevant to this appeal) a pro forma invoice. Expeditors would receive a pro forma invoice from its supplier.

(4) Expeditors would also send its supplier a "New Supplier Declaration" which the supplier was required to sign and return. That document alluded to the risk of MTIC fraud, required the supplier to confirm that it had good title to the goods and that it did not know, or have reasonable grounds for suspecting, that any VAT associated with the sale (or any previous supply) would go unpaid. It also required the supplier to confirm that it had made 18 specific due diligence checks on its own supplier.

(5) As noted at [63], the relevant goods would typically be located at a freight forwarder. Expeditors evidently made some attempts to require that freight forwarder to sign a declaration to the effect that Expeditors' customer had full title to the relevant goods. However, in practice no such written declaration was ever made.

(6) Expeditors would send a request to an inspection company, A1 Inspections Limited ("A1 Inspections") requesting an inspection of the goods and a scan of IMEI numbers. Expeditors' usual practice was to request that 100% of the stock be scanned and inspected. (The extent to which inspections were actually performed in response to these requests was disputed and we make findings on this issue at [80] below.)

(7) Assuming that Expeditors was happy with the inspection report, it would send a written instruction to the freight forwarder requiring it to ship the goods "on hold" to the freight forwarder selected by Expeditors' supplier. For Deals 2 and 3 (where Expeditors' customer was based in the Netherlands), this instruction resulted in goods being shipped to Interaction Logistics BV in the Netherlands. In the other deals, where Expeditors' customer was based in Denmark, the goods would be shipped to Kuehne & Nagel in Denmark. Expeditors used a standard form to make this request which included a section requiring its freight forwarder to acknowledge that the goods would remain "fully in your control at our designated freight forwarder until written and verbal confirmation is received from Expeditors". On occasions, the freight forwarder did not sign and return that form in which case Expeditors obtained a verbal confirmation to this effect.

(8) Once Expeditors' customer had satisfactorily performed its inspections it would pay Expeditors the price due. Once Expeditors had received payment from its customer, it would pay its supplier.

(9) Expeditors maintained an online banking account with the FCIB. In Deals 1 to 6, it both received payment from its customer, and paid its supplier using its FCIB account. In Deals 7 to 10, Expeditors made and received payment otherwise than through its FCIB account.

(10) Having received payment, Expeditors would send release instructions to the freight forwarder instructing it to release goods to Expeditors' customer.

(11) Expeditors would send to its customer, and receive from its supplier, formal invoices marked "paid" once payments had cleared.

Particular points arising from Expeditors' method of transacting

Description of the phones

66. All of the 10 transactions that are relevant to this appeal involved mobile phones with a Central European specification (so that, for example, those phones had chargers that were appropriate for use in Central Europe and not appropriate for use in the UK). Expeditors was, therefore, in all 10 deals purchasing phones that were not suitable for use in the UK from a UK supplier and then selling those phones to a purchaser overseas. As noted at [58], this method of transacting meant that Expeditors had to fund the VAT that its UK supplier was being charged. Conceptually Expeditors could have entered into "triangulation" transactions under which it purchased phones with a Central European specification from a supplier in Europe and on-sold those

phones to its customer in Europe. Such a triangulation transaction would not require Expeditors to fund a VAT-inclusive purchase price but, despite this potential advantage, Expeditors did not investigate the possibility of entering into triangulation transactions as it considered them to be impracticable.

"Ship on hold" arrangement

67. In all of the deals at issue in this appeal, a "ship on hold" arrangement of the kind described at [61] was implemented. Such an arrangement involved risks for Expeditors' supplier who was parting with possession of the phones before receiving payment from Expeditors. Therefore, the risk for Expeditors' supplier was that, if Expeditors was subsequently unable or unwilling to buy them and pay the purchase price due, the supplier would be left without the phones or the cash value of them. Effectively, therefore, in all ten deals, Expeditors' supplier was trusting Expeditors, a company that was not at all credit worthy, with mobile phones worth several hundred thousand pounds. Mr Howard said in his evidence that a supplier was only taking this risk the first time it traded with Expeditors since, after Expeditors had "delivered" successfully on the first deal, it could be expected to do so in the future. We do not agree: even if a deal with Expeditors had been completed successfully in the past, there was always a risk that Expeditors' precarious financial position could worsen. We considered, therefore, that in all ten deals, Expeditors was benefiting from very generous terms from its suppliers: more generous than the terms that might be expected when two companies are trading at arm's length.

68. We accept that, in the world of business, it is often necessary to take risks. We have, therefore, considered whether there was a good reason why Expeditors' suppliers would need to take the unsecured credit risk on Expeditors referred to at [67]. The stated reason for the "ship on hold" arrangement was so that Expeditors' customer could inspect the goods in its own jurisdiction rather than in the UK. Mr Howard was pressed in cross-examination as to why the goods could not be inspected in the UK at the freight forwarders with whom Expeditors' supplier deposited the goods. The reason Mr Howard gave was that, even if a satisfactory inspection took place in the UK, Expeditors' customer would still be exposed to the risk that the wrong goods would ultimately be shipped. Therefore, the customer wanted to inspect the <u>actual</u> goods that had been shipped and that could only be done once the goods had been shipped to the customer outside the UK. We accepted that Expeditors' customer would still be exposed to the risk of a shipping error if it inspected the goods in the UK. However, in such a case it would doubtless have a claim against the freight forwarder involved. Moreover, we did not consider it to be characteristic of an arm's length bargain for Expeditors' supplier to agree to assume credit risk on Expeditors simply to protect Expeditors' customer against the risk of a shipping error.

Expeditors' process of negotiating transactions

69. Mr Howard's evidence was that each day he would have telephone discussions with up to 40 potential counterparties who might be interested in supplying mobile phones to Expeditors. For each of the transactions at issue, we were shown Daily Price Reference Sheets that Mr Howard completed. Those Daily Price Reference

Sheets included a number of sections that could be completed in manuscript. In one section, Mr Howard would record his "general comments on market dynamics at present and justification for the market price". The remainder of the sheets included space to record a "minimum [of] three quotes per product type". This section had columns for Mr Howard to record a mobile phone model, the supplier spoken to, the time the discussion with that supplier took place and the "quoted cost" for the supplier to sell that model of phone.

70. Each of the Daily Price Reference Sheets recorded prices that had been offered by suppliers who could not offer Expeditors a "ship on hold" facility and with whom, therefore, Expeditors could not transact. In the Daily Price Reference Sheets we reviewed, in every case (with the exception of Deal 10) there was only one record of a price offered by a supplier who was prepared to offer Expeditors "ship on hold" terms. The Daily Price Reference Sheet for Deal 10 suggested that both LTL and Santok (who were both prepared to offer "ship on hold" terms) offered Expeditors terms. In all cases Expeditors ultimately transacted with the chosen supplier at the price recorded on the Daily Price Reference Sheet. That price was never the lowest price recorded on the sheet but was, in all cases, a pound or two higher than the lowest quoted price. Ms Goldring put it to Mr Howard in cross-examination that the Daily Price Reference Sheets did not evidence genuine negotiation on price as Expeditors could only purchase from suppliers who would offer a "ship on hold" facility (so it did not matter what prices other suppliers offered as Expeditors could not transact with them). In any event, since Expeditors always transacted at the price shown on the Daily Price Reference Sheets, she suggested to Mr Howard that there was no negotiation on price.

71. In response to Ms Goldring's questions, Mr Howard said that there was genuine negotiation on price and that what was recorded in the Daily Price Reference Sheets was not the price offered, but the final negotiated price. Therefore, it was not surprising that Expeditors ultimately transacted at that price. In cross-examination, Mr Howard said of the prices recorded in the Daily Price Reference Sheets:

> That's the negotiated price. It wouldn't be in the Daily Price Reference Sheets until it's become a deal, so I can talk and try and get the prices I want to enable an export which is a gross mark-up of 7 per cent, but if I can't I wouldn't write up any paperwork.

72. We have not accepted Mr Howard's explanation. The Daily Price Reference Sheets contained a column to record the "quoted" price, so Mr Howard's explanation is inconsistent with the terms of the form itself. It is also inconsistent with his witness statement in which, at paragraph 38, he described the Daily Price Reference Sheets as recording the prices at which stock was offered. Moreover, the sheets all contained a number of recorded prices. Expeditors could not transact with all of the potential suppliers referred to on the sheets (since they did not offer "ship on hold" terms). We did not believe that Mr Howard would have spent time and effort negotiating prices with suppliers with whom he was unable to transact. Moreover, Mr Howard's explanation is in some instances not consistent with the times at which the Daily Price Reference Sheets record conversations as taking place. For example, the Daily Price Reference Sheet for Deals 4 and 5 records Mr Howard talking to LTL at 2pm (and

records a price, in relation to LTL, of £110 per Nokia 6230i and a price of £115 per Nokia 7610). At 2.30pm the same Daily Price Reference Sheet records Mr Howard talking to 3G (and records a price, in relation to 3G of £110 per Nokia 6230i and of £116 per Nokia 7610). If Mr Howard were right that the prices recorded were negotiated prices, then it would follow that, half an hour after negotiating successfully with LTL (who could offer him a "ship on hold" facility), he conducted a separate negotiation with 3G who could not. We did not consider that made commercial sense. It was also not consistent with Mr Howard's evidence that he was operating in a fast-paced market where he was always subject to the risk that he would be "gazumped" on price. In those circumstances, we considered that Mr Howard was more likely, having agreed terms with LTL, to seek to move as quickly as possible to close the deal with LTL rather than to seek to negotiate a new deal with a supplier with whom he could not contract. In addition, the Daily Price Reference Sheet for Deals 7 and 8 records both Santok and Unique offering prices at the same time (2.30 pm). We did not consider that Mr Howard could conduct a meaningful negotiation on price with two potential counterparties at exactly the same time.

73. Given that we have not accepted Mr Howard's explanation of the prices referred to in the Daily Price Reference Sheets, it follows that we accept Ms Goldring's submissions that there was little negotiation on price, and this is borne out by the fact that, as noted at [56], Expeditors made a margin, in all of the deals at issue in this appeal of 7 per cent or thereabouts.

Expeditors' contractual and other documentation

74. The contractual documentation to which Expeditors was party did not, in material respects, reflect the transactions that were undertaken.

75. In Deals 2 and 3, it was not clear to us precisely when Expeditors was due to pay its supplier. In Deals 1, 4, 5 and 6, Expeditors' supplier, LTL, stipulated that payment for the goods was due on delivery of a pro-forma invoice. However, Expeditors did not comply with this term and in practice Expeditors only paid LTL after Expeditors had itself received payment from its customer as summarised in the following table:

Deal Number	**Due Date for Payment in accordance with LTL invoice**	**Date payment actually made**
1	5 May 2006	12 May 2006
4 and 5	23 May 2006	26 May 2006
6	23 May 2006	1 June 2006

76. The stated position set out in pro forma invoices that Expeditors received from Santok in Deals 7, 8, 9 and 10 was that the purchase price was due "in advance". Nevertheless, Expeditors paid Santok only after it had received payment from its own customer (Sunico).

77. Similarly, Expeditors' counterparties (with the exception of Sunico) did not adhere to contractual terms when making payments to Expeditors. Sunico paid Expeditors on the due date for payment in Deals 7 to 10. The dates on which Expeditors was due to be paid in Deals 1 to 6, and the dates on which it was actually paid, are summarised in the following table:

Deal Number	Due Date for Payment	Date payment actually made
1	8 May 2006	12 May 2006
2 and 3	12 May 2006	23 May 2006
4 and 5	25 May 2006	26 May 2006
6	25 May 2006	1 June 2006

78. Despite the importance of a "ship on hold" facility to Expeditors' business model, it did not seek to include contractual terms in its own terms and conditions requiring its suppliers to afford it such a facility. The "ship on hold" facility was reflected in ancillary documents associated with each deal, for example the written instructions that Expeditors would issue to its freight forwarder referred to at [65(7)]. However, Expeditors had no contractual right to require its suppliers to permit Expeditors to ship the suppliers' goods "on hold" to Expeditors' own customer before the point at which those goods became Expeditors' property.

79. Expeditors' contractual documentation was also in places contradictory. For example, Clause 7.1 of Expeditors' standard terms of purchase stated that title and risk in goods would pass to Expeditors when Expeditors paid the purchase price due. However, Clause 2.2 of those terms stated that title would pass at the earlier point when a purchase order acceptance was issued.

Inspection reports

80. In relation to all deals at issue in this appeal, Expeditors requested A1 Inspections to inspect the goods in the UK. In all deals, the request for an inspection was made on the same day as that on which Expeditors issued its formal invoice to its customer. However, while we saw evidence of Expeditors requesting inspection reports in connection with all deals, we were not shown evidence that inspections had been performed in Deals 1, 2, 4 and 5. Mr Howard stated in evidence that he lost the inspection reports for these deals when the hard disk of his laptop computer corrupted and that attempts to recover those documents from the corrupted hard disk were unsuccessful. He also said that he had not been able to recover the reports from A1 Inspections as HMRC had seized a number of A1 Inspections' documents as part of their own investigations into that company. Given that we saw inspection reports for other deals, and given that there was no challenge to the authenticity of the requests for inspection reports that we saw, we have accepted that A1 Inspections performed

inspections for all deals. However, we will not make any findings as to the conclusions of the inspections in Deals 1, 2, 4 and 5.

81. The inspection report for Deal 3 was dated 10 April 2005 some 13 months before Deal 3 actually took place. If this is simply a typographical error, the author would have had to make a mistake with the date, the month and the year of the report.

82. On Deal 6, Expeditors sent a request to A1 Inspections on 23 May 2006. It issued instructions at 3.30pm on the same day that the goods be shipped to Kuehne & Nagel in Copenhagen. Nevertheless, A1 Inspections' report stated that the inspection was performed on 24 May 2006. We were satisfied that it was possible for the inspection to take place on 24 May 2006 as stated (since other documents made it clear that the goods in question did not actually leave the UK until 21:07 on 24 May 2006). However, from the timeline outlined above, we concluded that, at least on Deal 6, Expeditors was happy to issue instructions to ship the goods to its purchaser before it had received the results of the inspection. Mr Howard suggested in his response to questions in cross-examination that the instructions to ship the goods must have been countermanded orally following A1 Inspections stating that they were unable to perform their inspection. However, in the absence of any contemporaneous documentary evidence we prefer the conclusion set out above which is supported by contemporaneous documents.

83. On Deals 7 and 9, the A1 Inspections report indicated that there were "cut outs" on all the cartons of goods. From Mr Stone's evidence, we concluded that, when goods arrive in the UK from overseas, the outer carton containing those goods would be stamped with a UK customs stamp. If a carton of goods contains multiple customs stamps, that would indicate that they have been in the UK before which might, in turn, suggest that they were involved in a carousel fraud. Therefore, those participating in such a fraud might choose to cut out existing customs stamps from cartons to disguise the fact that they have been in the UK before. Accordingly, one possible reason for "cut outs" might be that customs stamps have been removed to disguise the involvement of the goods in carousel fraud.

84. However, Mr Howard explained, and we accepted, that "cut outs" did not have to relate to customs stamps. A large-scale retailer of mobile phones might have bought too great a quantity of a particular mobile phone but might find that it could not sell them all to its retail customers. It might, therefore, wish to sell its excess stock, but might not want the market as a whole to know that it was doing so as this information could be regarded as commercially sensitive. In those circumstances, a wholesale purchaser might agree to cut out "destination stickers" from the stock that would reveal the identity of the original vendor.

85. Although the A1 Inspections report identified that all boxes contained "cut outs", we were not satisfied that Expeditors took any material steps to establish the nature of the "cut outs" and whether they amounted to an "innocent" cutting out of destination stickers or a potentially more suspicious cutting out of customs stamps.

Expeditors' funding arrangements

86. As noted at [58], Expeditors needed to fund the difference between the purchase price that it had to pay its UK supplier (which included a VAT element) and the VAT-free sale price that it would receive from its customer. Mr Howard, in his personal capacity, had a mortgage on his house. However, Expeditors did not obtain the funds to fund the VAT component of its purchase price from mainstream lenders.

87. On 27 April 2005, Expeditors borrowed £50,000 from Santok who sold phones to Expeditors in Deals 7 to 10. Mr Howard obtained this loan after conversations between him and Mr Jay Pau, a director of Santok, at a funeral. While Mr Howard said in his evidence that Santok's core business was phone accessories, and we have accepted that, Santok were, at least to the extent of their phone dealing activities, in competition with Expeditors. Therefore, by entering into this and subsequent loans, Santok was lending money to a competitor.

88. The agreement documenting the loan from Santok on 27 April 2005 was less than one page long. It provided that the loan was to be repaid no later than 1 June 2005 and that it carried interest of 5% per month. The loan was stated to be personally guaranteed by Mr Howard. However, Mr Howard did not sign the loan agreement in his personal capacity; he signed only as a director of Expeditors.

89. Expeditors did not repay this loan by the due date of 1 June 2005. On 6 June 2005, Mr Howard wrote to Mr Pau to confirm an agreement apparently reached by telephone to the effect that, due to the late repayment "I am happy to settle on giving you 65% of the Net Profit".

90. Even though Expeditors had not complied fully with the terms of the first loan, on 27 July 2005, Santok agreed to lend Expeditors a further £32,000 on the terms of another short loan agreement. That loan was expressed to be repayable by 1 September 2005 and carried interest at 10% per month. In fact, an examination of Expeditors' bank statements reveals that Santok paid £50,000 to Expeditors on 27 July 2005 (rather than the stated £32,000 principal amount of the loan). Expeditors did not repay on time: it paid £18,000 to Santok on 27 July 2005 and a further £32,020 on 18 October 2005. The sum of these payments was not sufficient to discharge the interest (at 10% per month) that would have been due on a loan of £50,000 (or of £32,000).

91. Despite the defaults outlined at [90], on 27 October 2005, Santok advanced Expeditors a further loan of £27,000 pursuant to an undated loan agreement.

92. Expeditors used the money borrowed from Santok as set out above to fund transactions in mobile phones other than those with which this appeal is concerned.

93. Expeditors also obtained loans from a company called Focal Computers Limited ("Focal"). Expeditors obtained those loans after Mr Howard got into a conversation with Marcus Walton, a director of Focal at a birthday party of Stuart Hill, a friend of Mr Howard. Mr Howard had not met Mr Walton previously. However, Mr Hill introduced them and explained that Mr Walton had funds to invest but that since Mr

Hill did not want to use Mr Walton's finance (as he had funds of his own) it might be that Mr Howard could use it instead. Mr Howard had a subsequent meeting with Mr Walton to explain his business model.

94. Between July 2005 and May 2006, Focal made nine separate loans to Expeditors. While the amount of those loans that remained outstanding at the date of the hearing was in dispute, we did not understand there to be any significant dispute over the amounts originally advanced which totalled over £400,000. For two of these loans, we were not shown loan agreements. However, the other loans were documented in loan agreements of less than one page. The material provisions of the loan agreements we saw were as follows:

(1) Each loan was stated to be made for a period of one month.

(2) Each loan was stated to be "personally guaranteed" by Mr Howard. However, Mr Howard did not sign the loan agreement in his personal capacity; he signed only in his capacity as a director of Expeditors.

(3) Each loan stated that the "Net Profit generated by the loan will be shared as agreed", but did not record what that agreement was or how "Net Profit" was to be calculated.

95. The loan agreements dated 7 February 2006 and 23 March 2006 were for £44,949.40 and £35,060.60 respectively and the aggregate of these principal amounts was £80,010. On 6 February 2006, Focal paid £80,000 into Expeditors' bank account. This was said to be the principal amount of the loan advanced pursuant to loan agreements of 7 February and 23 March 2006. Therefore, Focal advanced the principal amount of both loans before even obtaining a signed loan agreement. While a loan agreement for £44,949.40 was signed the next day, the loan agreement for £35,060.60 was not signed until 6 weeks after the funds were advanced.

96. In 2005/06, Focal was applying to become VAT registered, but failed pre-credibility checks. In order to support its assertion that it was running a viable business, Focal provided HMRC with invoices that it had issued to Expeditors for "commission" or "consultancy fees". The amounts recorded on those invoices matched Focal's calculation of its share of "Net Profit" due from Expeditors under the agreements referred to at [94]. In cross-examination, Mr Howard sought to defend this description of the services that Focal was providing stating that, since it was not a bank, when Expeditors obtained finance from Focal it was effectively "consulting" with Focal in order to obtain finance. We found that explanation wholly unconvincing: Focal was lending money for a return equal to a percentage of the profits generated by the use of money. That could not fairly be described as "consultancy". We can see that a commercial person might, loosely, describe the arrangement as involving Focal receiving "commission". However, only one invoice referred to the receipt of "commission". We have concluded, therefore, that the other invoices that Focal sent to Expeditors (which referred to the receipt of "consultancy fees") deliberately mis-stated the nature of the business relationship between Focal and Expeditors and that Expeditors acquiesced to that mis-statement by not, for example, requiring the issue of invoices that correctly described the nature of the services.

97. HMRC were aware, before the transactions in the 05/06 VAT period on which input tax recovery was denied, that Expeditors was using money that it borrowed from Focal to finance its activities. We were referred, in particular, to correspondence between Mr Howard and HMRC in February 2006 in which the loans from Focal were mentioned.

Expeditors' knowledge of the composition of the deal chains

98. In his witness statement, Mr Howard stated that he had no knowledge of any trader involved in the transaction chains other than his supplier and his customer. In answers to questions in cross-examination, he went further than this stating that he had no idea of the length of the transaction chains. However, he subsequently accepted that he was aware that Expeditors' supplier itself had a supplier and that Expeditors' customer itself had a customer. Therefore, he was aware that the transaction chains contained at least five participants. Moreover, in his evidence on the enquiries that he made with HMRC at Redhill referred to in the next section, Mr Howard made it clear that he realised that there was a chain of transactions leading up to Expeditors' purchase.

99. In a letter of 26 October 2006 addressed to HMRC, which was written just five months after the transactions, Mr Howard's accountant wrote:

> Our client is adamant that he had no knowledge regarding this stock before he purchased it or what happened after he sold it.

100. Nevertheless, in answers to questions put to him in cross-examination, Mr Howard referred to his belief (which was not mentioned in his witness statement) that he understood his customers would be on-selling the phones to network operators and authorised distributors in Europe after installing proprietary software on the phones. Later on in this decision, we will address the question of whether Mr Howard was aware of the level of orchestration in the deal chains. For the time being we will simply note that Mr Howard's evidence in this respect was inconsistent: he both sought to downplay the extent of his knowledge to support Expeditors' argument that it was not aware that its transactions were connected to VAT fraud while simultaneously referring to his apparent knowledge of what his customers were proposing to do with the phones in new evidence given for the first time during cross-examination.

Expeditors' enquiries with Redhill

101. At the time of the transactions with which this appeal is concerned, HMRC offered taxpayers the ability to validate the VAT status of their customers and suppliers. Very broadly, a taxpayer wishing to use this service would be asked to send HMRC's office in Redhill, a copy of a letter of introduction relating to the counterparty, a copy of the counterparty's VAT certificate and, if applicable, a copy of the counterparty's certificate of incorporation. HMRC officers would compare the information received with that held on HMRC's systems. If the information matched, HMRC would send the taxpayer a letter confirming this. However, HMRC were at pains to stress that they were simply confirming that the VAT registration had been

validated and were not giving any wider "authorisation" to trade with a particular counterparty. HMRC typically did this by including the following paragraph in letters that they sent to taxpayers when validating VAT information:

> This confirmation is not to be regarded as an authorisation by this Department for you to enter into commercial transactions with this trader and any input tax claims may be subject to subsequent verification.

102. HMRC also at the time undertook "chain checks" in its Redhill office. These were undertaken (depending on HMRC resources and capacity) where HMRC received new information on a particular trader that was inconsistent with information received previously. Officer Mendes said in his evidence that such checks were not taken out at the request of taxpayers, but rather happened on HMRC's own initiative. To perform a "chain check", HMRC officers would contact a trader in a chain, ask from whom they were purchasing goods and repeat the process with each new supplier identified.

103. Mr Howard said in his evidence that two tasks that were crucial in enabling a deal to take place were obtaining verification of his supplier's VAT information from HMRC and obtaining "VAT verbal approval" from HMRC. He explained that the "verbal approval" referred to involved Mr Howard calling HMRC officers (for example Clive Palmard, Dev Patel, Pete Wyatt and an officer referred to as "Sobeta S") in Redhill and asking "Have you had all of the paperwork in from my supply chain?" By this he meant to ask whether everyone in his supply chain had sought to verify the VAT registration of their immediate supplier using the process outlined at [101]. He said that this was not a request for a "chain check", just a request for confirmation that everyone in the relevant chain had verified their own supplier's VAT status. His evidence was that, in practice, HMRC officers were prepared to give an oral confirmation to this effect although when they did so, they were at pains to state that they could not confirm that this state of affairs would persist at a later date. Therefore, for that reason when completing his "back to back tracking and approval form" referred to at [63], Mr Howard would often write "unable to confirm" or the single word "unable" in the "tick box" column next to the reference to securing HMRC verbal approval. That was certainly an unusual way of recording what Mr Howard said was essentially a positive confirmation (albeit with the caveat that it might not be true in the future). However, Mr Howard's clear evidence was that this was the conclusion that he intended to record.

104. Expeditors also stressed the importance of the "verbal confirmations" from HMRC in Redhill in a letter to the Tribunal during the course of the case management of this appeal. In that letter, Expeditors stated that the input of Terence Mendes was absolutely crucial to every transaction that Expeditors undertook and requested information on how to ensure that Terence Mendes attended the hearing in order that his evidence on this point was heard. (Of course, since Officer Mendes was giving witness evidence, no witness summons would be necessary and Expeditors were, in this letter, effectively giving advance notice of points that it wished to put in cross-examination. However, the implication of Expeditors' letter was clear – namely that it considered that strong reliance was placed on Officer Mendes's confirmations.)

105.Officer Mendes said that he had no recollection of any conversations with Mr Howard. Moreover, he said that HMRC officers could not have fulfilled any request of the kind that Mr Howard said he made without conducting a "chain check" as only by conducting such a chain check could HMRC determine who the participants in the chain were. As noted, his evidence was that chain checks would not be undertaken in response to a taxpayer's request. Therefore, there was a clear conflict between Officer Mendes's evidence and that of Mr Howard.

106.We prefer the evidence of Officer Mendes who worked in the validation team at Redhill at the material times and thus had first-hand experience of the processes that HMRC officers undertook there. Firstly, it is clear that HMRC could only confirm that all participants in the chain had submitted paperwork if they first knew who those participants were. There was no challenge to Officer Mendes's evidence that HMRC could find this out only by conducting a chain check. Officer Mendes explained that the Redhill team were "inundated" with requests from taxpayers to validate VAT registrations. The process of undertaking a chain check referred to at [102] would self-evidently take time and HMRC's resources were limited and the Redhill office was very busy. We did not, therefore, consider that HMRC would vary their usual practice to give a verbal assurance that went beyond a mere verification of VAT registration to a particular taxpayer just because that taxpayer had requested it particularly given that, in order to give that assurance, they would need to perform a chain check and their practice was not to perform a chain check simply because a taxpayer requested one. We have therefore concluded that Mr Howard's evidence as to the extent of verbal confirmations that he received from Redhill was not true. It follows that we have concluded that, when he filled in his "back to back tracking and approval forms" for these deals in 2006, given Mr Howard's explanation outlined at [103] as to what he meant by entries on those forms, Mr Howard was recording that verbal confirmations had been received from HMRC when they had not been received.

107.It was, however, clear that Expeditors sought, and obtained, verification of VAT registrations using the process outlined at [101] in all of the transactions at issue in this appeal. In almost all cases, that verification was received prior to the transactions taking place. However, in Deal 1, Redhill's verification of LTL's VAT registration came through on 12 May 2006, which was some four days after Expeditors shipped the goods to Blue Star (and some seven days after the date of Expeditors' invoice to Blue Star).

Loans that Expeditors made

108.On 25 July 2006, HMRC wrote to Expeditors to inform it that its claim for input tax credit for the 05/06 VAT period was to be subject to extended verification. On 11 August 2006, Expeditors lent £80,000 to Santok on an unsecured basis. When asked about this loan in cross-examination, Mr Howard initially said:

> It was to do a deal that I couldn't do because I had my verification letter by then, so I was sat there doing nothing.

109.Having given that answer, Mr Howard sought to downplay the link between the extended verification and his ability to do deals suggesting that the reason that there was a "deal he couldn't do" was because it involved accessories (which were Santok's area of expertise) rather than handsets (which were his, and Expeditors', area of expertise). We found that explanation unconvincing as it was inconsistent with answers he gave just moments previously. We also noted that Mr Howard had previously referred to the person who owned all the shares in Santok as a "multi-millionaire" and that Expeditors' loan to Santok appeared to involve Expeditors, a company with "zero financial strength" lending money to a company owned by a "multimillionaire".

110.We have therefore concluded that Expeditors decided to lend £80,000 to Santok not in order to make a genuine loan but rather to provide a rationale for the making of a payment to Santok which was needed because of some other aspect of their dealings.

The orchestrated nature of the deal chains

111.In this section, we examine the characteristics of the deal chains in issue in this appeal and explain our view that they formed part of an orchestrated fraud. Few, if any, of the facts discussed in this section were in dispute and Expeditors accepted that, with hindsight, it was clear that all 10 transactions were connected with an orchestrated fraud. However, as we have noted, Expeditors denies that it knew, or should have known of the fraud and submits that, while there was an orchestrated fraud, that fraud was orchestrated by others.

General patterns in the chains

112.All of the chains involved mobile phones passing through the hands of a large number of traders in a short space of time. For example, in Deals 2 and 3, the phones left Copenhagen on 10 May 2006 and passed through the hands of one French and eight UK companies in just two days. In Deal 10, the goods left Sunico in Copenhagen on 29 May 2006, passed through one Belgian and six UK companies and were dispatched back to Copenhagen two days later. In other deals, the documentary evidence suggested that the goods were first dealt with by a UK freight forwarder on one day, passed through the hands of six or more companies in the chain, and were then dispatched outside the UK on the next day.

113.Five of the ten deals (Deals 1 and 7 to 10) were "carousels" in the sense that the phones in question originated with either Megatek or Sunico at the beginning of the chain with Expeditors or another selling the phones to the same traders at the end of the chain.

114.The deal chains were in all cases long. Buffer traders in the chains made predictable mark ups expressed in round numbers of pence per phone. There were similarities in the composition of different chains. For example, Lagan (UK) Ltd, Jos (UK) Ltd, New Order Trading Limited, Santok, Expeditors and Sunico participated in

all of Deals 7 to 10 in the same order. NTS Telecom Limited, Reya Limited and Tracker Trading Limited appeared in Deals 1, 2 and 6 in the same order.

115. Some of the deal chains included two or more companies with an affiliation to each other. For example, in Deals 1, 2 and 3 the EC companies Compucell and Blue Star appear at different ends of the same chain. However, these companies were already known to each other as demonstrated by the fact that Blue Star provided a reference as part of FCIB account opening procedures stating that Compucell was one of its customers. From July 2006 (after Deals 1 to 3 took place), Compucell and Blue Star had a director in common. Given Mr Corkery's expert evidence outlined at [136], in ordinary circumstances, we considered that there would be an incentive for companies who already knew each other to seek to cut out other participants in the deal chains and deal directly between themselves.

Participants in the chains and "Operation Apparel"

116. In 2005 and 2006, HMRC officers undertook a large-scale criminal investigation into suspected MTIC fraud. As part of that investigation, HMRC performed electronic surveillance of conversations involving suspected conspirators in that fraud. The Operation Apparel evidence indicated that MTIC fraud involved a team of fraudsters orchestrating transactions, specifying the entities that were to transact with each other and the price at which they would transact. Those orchestrated deal chains were set out in diaries (the "Diaries") that were seized as part of the Operation Apparel investigation. HMRC also seized, as part of Operation Apparel, a number of spreadsheets that could be cross-referred to transactions that had actually taken place.

117. LTL (Expeditors' supplier in Deals 1 to 6) was named in the Diaries on 63 occasions. In addition, having traced the deals set out in the Diaries, HMRC established that there was one occasion in which, despite not being named in the Diaries in relation to a particular deal, LTL participated in the relevant deal chain.

118. Tracker Trading Ltd (the supplier to LTL in Deals 1, 2, 3 and 6) and Electron Global Ltd (who supplied phones to LTL in Deals 4 and 5) featured a number of times in both the Diaries and the spreadsheets. Sunico (Expeditors' customer in Deals 7 to 10) was named in the spreadsheets on 61 occasions. Expeditors was <u>not</u> named in either the Diaries or the spreadsheets.

119. Officer Bradshaw's evidence, which we have accepted, showed how an entry in the Diaries of a deal chain involving LTL could be shown to correspond with an actual deal chain involving multiple sales and purchases of 4,410 CPUs. In addition, we accepted Officer Bradshaw's evidence that of the 47 actual transactions to which LTL was party between March 2006 and June 2006, 10 were sales to Expeditors (and six of those sales were part of transaction chains considered in this appeal). 30 of the remaining 37 deals to which LTL was party could be identified with transactions set out in the Diaries. Of those 7 deals remaining which could not be shown to be reflected in the Diaries, 6 involved LTL transacting with a company that was named in the Diaries.

120. One feature of transactions analysed as part of Operation Apparel was that they typically involved one party (described by the orchestrators as the "third party payer") paying money, not to the company that ultimately defaulted on its VAT obligations, but to another company fulfilling the role of the "catcher" or the "strong European" (again using the language of the orchestrators). The apparent aim of this arrangement was to ensure that the defaulting trader at no point had cash sufficient to discharge its VAT obligations, presumably to ensure that HMRC were not practically able to collect the VAT due.

121. In addition to the overlaps with counterparties taking part in "Operation Apparel" transactions, other parties connected with Expeditors' transactions were involved in fraud. Sunico (Expeditors' customer in Deals 7 to 10) was determined by the High Court to be implicated in unlawful means conspiracy by the High Court in *HMRC v Sunico and others* [2013] EWHC 941 (Ch) and the High Court's judgment makes it clear that Hawk, a freight forwarder that Expeditors used in connection with a number of the transactions, was also implicated in that conspiracy. Mr Howard during the hearing expressed the view that, with the benefit of hindsight, he considered that Santok (Expeditors' supplier in Deals 7 to 10) was involved in MTIC fraud although, not having heard any witness evidence from Santok, we will not ourselves make a finding to this effect.

Payments in the chains and transfers of title

122. Officer Stock undertook a detailed analysis of payments associated with the 10 deals relevant to this appeal. That involved looking at payments into, and out of, the FCIB accounts of the companies involved in those deals, analysing the narratives associated with those payments in the FCIB records and matching the payments against invoices. In addition, Officer Stock was able to analyse the IP address that each participant used when logging into the relevant FCIB account to make payment. The substance of Officer Stock's analysis was not disputed, and we have therefore accepted it. We have drawn the following conclusions from that analysis.

123. In all of the deals (with the exception of Deal 6), funds moved in a circle. Money would leave the account of one participant in the chain (ostensibly as payment for mobile phones supplied pursuant to a particular invoice), would pass through a number of bank accounts before being received back into the same account as that in which they started.

124. All payments were made in sterling, despite the fact that a number of the traders involved were established in the EU and might, therefore, be expected to wish to receive payment in euro.

125. The payments were made at some speed. For example, in Deal 1, the nine payments involved were all made in a total of some six hours.

126. The payment flows in all of the deals did not match with the invoices in question in one important respect. In each deal, the relevant defaulting trader did not receive the (VAT inclusive) sale price of the goods that was stated to be due pursuant to the

relevant invoice. Rather, instead of paying this sum to the defaulting trader, that trader's customer typically made a "third party payment" to another company. This feature was also present in the diary entries connected with Operation Apparel.

127. In a number of the deals there were anomalies relating to the dates on which the various suppliers in the chain released goods to each other. For example, in Deal 5, goods were apparently not released to Megatek (who appeared right at the start of the chain in that deal) until 6 June 2006. Therefore, none of the subsequent participants in that deal chain could have had legal title to the goods until that date at the earliest. However, LTL, Expeditors' supplier in that deal, purported to release goods to Expeditors on 26 May 2006. A similar anomaly arose in Deal 10. However, these anomalies did not relate (directly) to Expeditors itself and we were not shown a single case in which Expeditors purported to release goods to its purchaser before its immediate supplier released goods to Expeditors.

Circularity involving the phones themselves

128. Mobile phones all have a unique identifying number (referred to as an "IMEI" number) which is in a machine readable form and can therefore be easily scanned into a database. HMRC maintain a database (referred to as "Nemesis") that keeps a record of IMEI numbers of which they have previously become aware. IMEI numbers can be entered into the Nemesis database if they have been scanned at key locations such as freight forwarders or export sheds. Alternatively, they can be entered if a trader provides them to HMRC as part of a package of information on a consignment of mobile phones. The IMEI numbers are recorded on Nemesis in "batch numbers" with each batch number corresponding to an occasion on which IMEI numbers have been entered into the Nemesis database. Each entry in Nemesis will contain basic information such as the date when the entry was made and the owner of the phones in question.

129. Officer Berry gave evidence, which was not to any significant extent challenged in cross-examination and which we have accordingly accepted, that all of Deals 4 to 10 involved mobile phones whose IMEI numbers had, either subsequently or previously, been recorded on the Nemesis database. That was significant as it was suggestive that those mobile phones were being traded in a carousel like pattern rather than being used by end users or consumers.

130. For one of the deals (Deal 6), by way of example, Officer Berry gave evidence as to how the IMEI numbers on two specific phones with which Expeditors had dealt, could be traced to other specific batches recorded on the Nemesis database. However, this was an example only. We were satisfied that at very least a significant proportion of the phones dealt with in Deal 6 had been dealt with on a previous occasion. Mr Howarth's cross-examination of Officer Berry did demonstrate that, as a consequence of the way the IMEI information was presented, it was not possible to say precisely what proportion of the IMEIs on phones in Deal 6 were recorded in Nemesis on a different occasion. However, while acknowledging that point, it was still clear that this was true of a significant proportion of the phones on Deal 6.

131. Officer Berry's evidence that all of Deals 4 to 10 involved at least some mobile phones whose IMEI numbers were scanned into Nemesis on a different occasion was not challenged. However, with the exception of Deal 6, we did not have any evidence as to the proportion of the phones of which this was true. We will not, therefore, make any findings on this point. We do not feel able simply to infer that because a significant proportion of the IMEI numbers associated with Deal 6 were entered into Nemesis on a different occasion, this was necessarily true of all the other deals.

132. The evidence on IMEI numbers referred to above demonstrates only that phones with which Expeditors dealt had previously been recorded onto Nemesis. We were not shown any evidence that Expeditors had itself dealt on two or more occasions in phones having the same IMEI numbers and we have therefore concluded that Expeditors did not do so.

The length of the chains

133. Mr Corkery gave expert evidence as to, among other matters, the "grey market" in mobile phone handsets. By the "grey market" he was referring to transactions in mobile phone handsets which are manufactured by equipment manufacturers and are destined for authorised distribution channels but which fall outside these channels and are traded by non-authorised dealers, potentially in a different country to the original designated country of distribution.

134. It was not entirely clear from Mr Corkery's expert report whether he had a full understanding of the precise nature of Expeditors' business. At paragraph 6.2.3 of his report, Mr Corkery recorded his understanding that:

> … during the period relevant to this appeal, the Appellant acted as an intermediary, seeking to add value through connecting buyers and sellers rather than by purchasing and holding stock.

135. It was not clear to us whether in that section Mr Corkery was suggesting that Expeditors was rewarded by receipt of a commission for introducing buyers and sellers to each other (which was not the case in relation to Deals 1 to 10) or whether he was referring to the fact that Expeditors traded on the "back to back" basis referred to at [58]. Elsewhere in his report, Mr Corkery referred to his understanding that "the Appellant traded in the wholesale market for mobile handsets, purchasing in the UK and selling to non-UK customers in Europe" which we considered to be an accurate description of Expeditors' business.

136. Because we were not satisfied that Mr Corkery had a detailed understanding of Expeditors' actual business, we will not deal in any great detail with his evidence as to whether Expeditors' business was consistent with "legitimate" grey market trading. However, Mr Corkery's evidence was still useful insofar as it related to economic points relevant to the wholesale trade in mobile handsets. In particular, we have accepted Mr Corkery's evidence that where mobile handsets are bought and sold by a large number of counterparties as part of a "chain" of transactions, there would be a strong incentive for parties in that chain to "disintermediate" other counterparties by transacting directly with either their customer or supplier as the case may be. We have

also concluded that such an incentive would be particularly strong for LTL and Santok (Expeditors' immediate suppliers). As noted at [29] to [55], the mark-ups that Expeditors made on its sales were higher than those made by LTL and Santok. Therefore, by "disintermediating" Expeditors, LTL and Santok could capture for themselves the profit that Expeditors was making. Similarly, LTL and Santok were themselves making healthy profits from their role in the chain. Therefore, if Expeditors could "disintermediate" LTL and Santok, it could realistically expect to make more profit. Moreover, Mr Howard in his evidence had explained that information on stock that various suppliers had available (and their quoted prices) could be obtained both on the internet and by calling up the supplier concerned and therefore "disintermediating" a particular participant in a chain would not be very difficult. We have therefore concluded that the fact that the chains in all of Deals 1 to 10 were so long is an indicator that they were part of an orchestrated fraud rather than being legitimate "grey market" transactions in mobile phones.

Expeditors' due diligence on counterparties

137. We were shown material relating to the due diligence that Expeditors performed on its counterparties.

Due diligence on Expeditors' suppliers

138. We accepted Mr Howard's evidence that, prior to trading with any supplier, Expeditors would obtain its VAT certificate, its certificate of incorporation, a sample of its company letterhead, its banking details and proof of a director's identity and address. As we have noted at [107], Expeditors also verified each supplier's VAT registration with HMRC at Redhill.

139. On 27 April 2005, LTL signed a "New Supplier Declaration" that Expeditors prepared confirming, among other points, that it had performed a number of items of due diligence on its own suppliers. Mr Howard accepted that he was not in a position to verify that LTL had actually performed this due diligence.

140. On 27 April 2005, Expeditors obtained a Dun & Bradstreet report on LTL, its supplier in Deals 1 to 6. That report indicated that LTL represented a significant level of credit risk, that LTL's financial strength was low and advised that Expeditors should seek assurances or guarantees before extending credit to LTL.

141. On 6 July 2006 (some 15 months after Expeditors started to trade with LTL) Expeditors obtained a report from Express Intelligence Ltd which involved among other matters, Express Intelligence visiting LTL's premises and conducting an interview with its director and company secretary. Ms Goldring pressed Mr Howard as to why this report was commissioned so long after Expeditors started dealing with LTL. We accepted Mr Howard's answer that Expeditors was continuously modifying its due diligence and had, by that stage only recently, become aware of Express Intelligence Ltd.

142.On 26 April 2006, Expeditors obtained a Dun & Bradstreet report on Santok (its supplier in Deals 7 to 10). That report indicated that Santok represented a "minimum risk of business failure", that Santok could support monthly credit of £110,000 and that only 18% of UK businesses had a lower risk of paying significantly late. Mr Howard also referred repeatedly in his evidence to his belief that Santok was controlled by "multimillionaire Jay Pau" and we accept that this belief supported Mr Howard's perception that Santok was a credit-worthy counterparty.

143. On 12 May 2006, Expeditors obtained a report from Express Intelligence Ltd on Santok.

Due diligence on Expeditors' customers

144.On 30 March 2006, Expeditors obtained a Dun & Bradstreet report on Bluestar (Expeditors' customer in Deals 1, 4, 5 and 6). That report stated that, as Bluestar was a newly incorporated company and had no accounts available, no conclusions could be expressed on its financial strength.

145.On 11 May 2006, Expeditors obtained a Dun & Bradstreet report on Compucell (Expeditors' customer in Deals 2 and 3). That report stated that Compucell was not recommended for credit, had a financial strength of EUR 2,723 and represented a significant level of risk.

146.There was a dispute as to whether Expeditors did any due diligence on Sunico. No due diligence material on Sunico was contained in the hearing bundles. Mr Howard said that he had previously handed over copies of that material to Officer Christopher at HMRC. Expeditors attached a copy of what it said were due diligence materials on Sunico to its written closing submissions. That material was not in evidence before the Tribunal as we refused Expeditors' application to adduce new evidence. However, since Expeditors performed due diligence on other customers, we are prepared to accept that Expeditors did perform due diligence on Sunico. We are also prepared to accept based on evidence that was before us that such due diligence would have showed that Sunico was financially strong and had a good credit rating.

Other points

Mr Howard's subsequent involvement with Santok

147.Mr Howard said in cross-examination that he considered that he (and Expeditors) had been duped by its suppliers and customers into participating in transactions that, it is now clear, were connected to fraud. Among the suppliers who had duped him, he named Santok. He did not, however, disclose in response to a number of questions that Ms Goldring asked him that he had worked for Santok. Eventually, when Ms Goldring asked him specifically if he had worked for any companies who had supplied phones to Expeditors in any of the deals in dispute, he confirmed that he had performed some work for Santok (as a contractor) for some 18 months. He could not remember when that work started saying that it could have been any time from 2008 to 2010.

148.Mr Howard's evidence was that he was happy to work for Santok (despite their involvement in transactions which had led to Expeditors being refused input tax recovery) firstly because Santok owed him £25,000 (representing part of the loan referred to at [108] that Santok had not repaid), secondly, because he was undertaking the project for Santok's accessories division whereas the transactions that had caused problems for Expeditors involved mobile phones rather than accessories and thirdly because, while with the benefit of hindsight he considered Santok to have been involved in MTIC fraud, he did not know this at the time. When asked why he had not mentioned Santok in response to Ms Goldring's earlier questions, Mr Howard said that it was because the project with Santok had been brought to an end in an unsatisfactory manner and he had parted on bad terms.

149.We found Mr Howard's evidence to be less than candid. We have concluded that he did not mention his project with Santok because he did not consider that it would be helpful to Expeditors' appeal if it were suspected that he had an ongoing association with that company. We also consider that there was some kind of relationship or understanding between Mr Howard and Santok that went beyond the kind of business relationship that might exist between a supplier and its customer and that this explained both Mr Howard's subsequent engagement with Santok and the loans that Santok and Expeditors made to each other.

PART II – THE LAW

150. There was no dispute that, but for the application of the Kittel principle referred to below, Expeditors would have the right to deduct input tax that it incurred on its purchases of phones in each of the 10 deals, to set that input tax against its output tax liability in the 05/06 VAT period and, to the extent input tax exceeded output tax, to obtain a payment from HMRC equal to the difference. That right arose pursuant to Article 167 and 168 of Council Directive 2006/112/EC (the "VAT Directive") which was given effect in UK law by sections 24, 25 and 26 of the Value Added Tax Act 1994 ("VATA 1994") and regulations made thereunder.

151.However, the decision of the European Court of Justice ("ECJ") in the joined cases of *Axel Kittel v Belgium; Belgium v Recolta Recycling SPRL* [2008] STC 1537 confirmed that taxable persons who "knew or should have known" that the purchases in which input tax was incurred were connected with fraudulent evasion of VAT are not entitled to deduct that input tax.

152.To reach this conclusion, the ECJ started by noting, at paragraph 54 of its judgment that preventing evasion and abuse is an objective recognised and encouraged by the Sixth Directive. At paragraph 55, the ECJ stated:

> Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, *Rompelman v Minister van Financiën* (Case 268/83) [1985] ECR 655, para 24; *Intercommunale voor Zeewaterontzilting (in liquidation) v Belgium* (Case C-110/94) [1996] STC 569, [1996] ECR I-857, para 24; and *Gabalfrisa* (para 46)). It is a matter for the national court to refuse to allow the right to

> deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see *Fini H* (para 34))

153. At paragraph 56 of its judgment, the ECJ stated:

> In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud irrespective of whether or not he profited by the resale of the goods.

154. The rationale for the above approach is that, in such a situation, the taxable person aids the perpetrators of the fraud and becomes their accomplice (paragraph 57 of the judgment) and that adopting this interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them (paragraph 58).

155. That line of reasoning led the ECJ to the conclusion, set out at paragraph 59 of the judgment:

> Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.

156. *Kittel* therefore decided that a taxpayer can lose entitlement to input tax credit if either that taxpayer "knew" that its transactions were connected with fraudulent evasion of VAT or "should have known" that this was the case. In *Mobilx Limited (in liquidation) v HMRC* [2010] EWCA Civ 517, the Court of Appeal analysed how these two separate tests should be applied and, in particular, whether it is sufficient for a taxpayer have knowledge or means of knowledge that it was more likely than not that the transactions were connected to fraudulent evasion of VAT. The Court of Appeal concluded that knowledge, or means of knowledge, of a possibility of connection to fraud was not enough in the following passage:

> A trader who knows or could have known no more than that there was a risk of fraud will find it difficult to gauge the extent of the risk; nor will he be able to foresee whether the circumstances are such that it will be asserted against him that the risk of fraud was so great that he should not have entered into the transaction. In short, he will not be in a position to know before he enters into the transaction that, if he does so, he will not be entitled to deduct input VAT. The principle of legal certainty will be infringed.

157. The Court of Appeal summarised how the Kittel test should be applied in the following paragraphs:

> The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'. Thus it includes those who should have known from the

> circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.
>
> The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion.

158. It is clear from paragraph 81 of the Court of Appeal's decision that HMRC have the burden of proving that the *Kittel* principle applies so as to deny a taxpayer the right to deduct input tax. It is also clear that each transaction to which the taxpayer is party must be considered on its merits. However, the requirement to consider each transaction on its merits does not mean that the circumstances surrounding each transaction must be ignored. The Tribunal is entitled to make inferences of fact from those surrounding circumstances. That is clear from the fact that the Court of Appeal endorsed the following statements made by Christopher Clarke J in *Red12 Trading Limited v HMRC* [2010] STC 589:

> Examining individual transactions on their merits does not, however, require them to be regarded in isolation without regard to their attendant circumstances and context. Nor does it require the tribunal to ignore compelling similarities between one transaction and another or preclude the drawing of inferences, where appropriate, from a pattern of transactions of which the individual transaction in question forms part, as to its true nature eg that it is part of a fraudulent scheme. The character of an individual transaction may be discerned from material other than the bare facts of the transaction itself, including circumstantial and "similar fact" evidence. That is not to alter its character by reference to earlier or later transactions but to discern it.
>
> To look only at the purchase in respect of which input tax was sought to be deducted would be wholly artificial. A sale of 1,000 mobile telephones may be entirely regular, or entirely regular so far as the taxpayer is (or ought to be) aware. If so, the fact that there is fraud somewhere else in the chain cannot disentitle the taxpayer to a return of input tax. The same transaction may be viewed differently if it is the fourth in line of a chain of transactions all of which have identical percentage mark ups, made by a trader who has practically no capital as part of a huge and unexplained turnover with no left over stock, and mirrored by over 40 other similar chains in all of which the taxpayer has participated and in each of which there has been a defaulting trader. A tribunal could legitimately think it unlikely that the fact that all 46 of the transactions in issue can be traced to tax losses to HMRC is a result of innocent coincidence. Similarly, three suspicious

> involvements may pale into insignificance if the trader has been obviously honest in thousands.
>
> 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.

159. There was no material difference between the parties as to the effect of the authorities. They were agreed that the Tribunal should ask itself four questions in relation to all 10 deals. If the answer to all four questions is "yes" in the context of a particular deal, then Expeditors is not entitled to deduct input tax incurred by it in that deal. The relevant questions are:

> (1) Was there a VAT loss?
>
> (2) If so, was it occasioned by fraud?
>
> (3) If so, were Expeditors' transactions connected with such a fraudulent VAT loss?
>
> (4) If so, did Expeditors know, or should it have known, of such a connection?

160. Expeditors admitted that the answer to the questions (1) to (3) set out at [159] was "yes" in the context of all 10 deals. Therefore, in the remainder of this decision we will consider only question (4) in relation to those deals.

PART III – CONCLUSIONS ON KNOWLEDGE AND MEANS OF KNOWLEDGE

161. The essence of Expeditors' arguments on this issue is that while, with the benefit of hindsight, it now sees that the transactions in which it was involved were connected with fraudulent evasion of VAT, it did not know this, or have the means of knowing this, at the time it entered into those transactions. Without limiting the generality of that argument, Expeditors argues that it was manipulated by the fraudulent architects of the overall scheme.

162. In this Part of the decision, we will set out conclusions that we have drawn from our findings of primary fact grouped under a number of different headings. We will then consider the extent to which those findings point towards a conclusion that Expeditors knew, or should have known, of the connection between its transactions and fraudulent evasion of VAT taking into account the arguments to the contrary that Expeditors has put forward. Having weighed up the competing inferences, we will then set out our overall conclusion on the question of knowledge or "means of knowledge".

Conclusions that can be drawn from our findings of fact

Absence of commerciality

163. We have concluded that all of the 10 transactions that are in issue were entered into as part of a pattern of trading activities that were lacking in ordinary commerciality. Moreover, Mr Howard as an intelligent and experienced businessman would have realised that this ordinary commerciality was lacking.

164. A fundamental lack of commerciality was demonstrated by the sheer size of the profits that Expeditors could make. In just five days in May 2006, Expeditors was able to make a profit of more than £138,000 on the purchase and sale of mobile phones despite the fact that it had no capital, no employees (other than Mr Howard) with deep knowledge of the mobile phone industry and was adding no value to the phones that it purchased. Mr Howard said in his evidence that 70% of his deals ultimately fell through and, since that was not challenged, we have accepted it. However, even taking that into account, the profit Expeditors was making was still completely disproportionate to the skills and effort that Expeditors brought to its transactions. Expeditors argued in its closing submissions that it had "particular access to stock or buyers or sellers", a factor that Mr Corkery said in his evidence might be an indicator of an ability to trade successfully in the "grey market" for mobile phones. We do not agree. Expeditors was able to transact with only four suppliers because of its need for a "ship on hold" facility and this scarcely represented "particular access" in a market where, as Mr Howard said himself, the simple act of calling a supplier or investigating a web site would make it clear which suppliers had stock to sell and at what price.

165. In order to make its profits, Expeditors, which, as Mr Howard freely admitted, had "zero" financial strength, needed access to working capital so that it could fund its VAT expense as noted at [58]. The Loans that it obtained to do this were similarly lacking in commerciality, and Mr Howard would have been aware of this. The Loans were advanced following social conversations on the terms of flimsy loan agreements. The lenders did not behave in the way that arm's length lenders would behave by, for example, advancing money before loan agreements were signed. Mr Howard had experience of taking a loan from a bank (as he had a mortgage on his house). He would have realised how different this behaviour was from that of arm's length lenders.

166. Expeditors sought to play down the lack of commerciality associated with the loan agreements by arguing in its closing submissions that, "in the real business world a handshake or a 300-page document can carry the same weight and both can be taken down legal channels if a default occurs". We quite accept that a loan agreement does not have to be lengthy in order to be enforceable. However, we do not accept that the loan agreements we were shown were representative of the "real business world" not least because they were so lacking in detail on key commercial terms and failed even to implement a personal guarantee from Mr Howard which would surely have been central to a lender's willingness to lend to a company of Expeditors' financial strength. Nor have we accepted Expeditors' arguments that Mr Howard was able to "talk his way out of" the consequences of defaults by deploying the same rhetorical

skills that he used when giving evidence. Even if a lender is advancing money on the strength of a short loan agreement, we would expect that lender to express real concern at defaults and not simply shrug them off as Santok did.

167. Mr Howard would have been aware that the "ship on hold" facility that Expeditors was offered was generous as only four of the 40 potential suppliers he spoke to each day were prepared to offer it. The "ship on hold" facility was a feature of all 10 deals at issue and it was uncommercial as it involved Expeditors' supplier trusting a company with no financial strength with large quantities of mobile phones with no security being given for the risk that they would not be returned. In its closing submissions, Expeditors argued that there was nothing uncommercial about a "ship on hold" facility and that Mr Howard had experience of this arrangement from his time at Unique. We do not agree with that submission as the situations of Unique and Expeditors were so different: Unique was a large established trader in mobile phones and Expeditors was, at the time, a new company with "zero financial strength".

168. As we have found at [56], Expeditors was able to make a predictable profit margin of around 7% without any material negotiation at all. In each of the 10 deals at issue, Expeditors purchased phones, at the price it was offered, from the only supplier who was prepared to offer it a "ship on hold" facility[2]. Mr Howard was aware that the chains in which he was participating evidently contained at least five participants (as noted at [98]. Yet he showed no interest in seeking to cut participants out of the transaction chains in order to secure increased profit for Expeditors.

169. There was, therefore, an absence of the kind of negotiation with suppliers that would characterise ordinary commercial relationships. Moreover, we have concluded from Mr Howard's untrue description of what information was recorded in the Daily Price Reference Sheets that those documents were prepared in order to create the misleading impression that Expeditors was engaged in activities involving more substance than simply purchasing from one of the few suppliers who would offer a "ship on hold" facility at the price originally quoted by that supplier.

170. The presence of all these uncommercial factors, of which Mr Howard was aware, in connection with transactions in the mobile phone industry which Mr Howard knew was "rife with fraud", points strongly to the conclusion that Mr Howard was aware that the 10 transactions in which Expeditors participated were all connected with fraudulent evasion of VAT.

Orchestration within the chains

171. Expeditors did not dispute that all 10 transaction chains in which it participated were orchestrated. In any event, that is clear from the circularity of payments and goods evident in those chains. The fact that there are marked similarities between the structure of the transaction chains in this appeal and those present in the "Operation

[2] Apart from Deal 10 in which both Santok and LTL (who were prepared to offer ship on hold facilities) offered terms to Expeditors.

Apparel" investigations has also satisfied us that these 10 transaction chains were orchestrated by a criminal syndicate.

172. We have not seen evidence that demonstrates conclusively that Expeditors knew of this orchestration (for example evidence demonstrating that Expeditors was told who it should sell to and purchase from). Ms Goldring made a number of submissions to the effect that, because of the orchestration of the deal chains, it necessarily followed that Expeditors was "in on it" (to use her expression) as the orchestrators of the fraud would not willingly put themselves in a position where they would lose control of their money (if Expeditors bought from the "wrong" party) or lose control of their phones (if Expeditors sold to the "wrong" party). We consider that this submission overstates matters. It is not a necessary inference although we agree that it is a possible inference, the strength of which needs to be assessed in the light of all other evidence.

173. If Expeditors was engaged in a normal commercial operation, we would not necessarily consider that the fact that, with hindsight, it could be shown that its transactions were part of a wider orchestrated fraud, would of itself provide a very strong indication that it knew of that fraud. The evidence from Operation Apparel is that those orchestrating the transaction chains did not feel the need, in many cases, to specify the precise identity of the broker who would participate in those chains. Such evidence as we have, in the form of the Diaries and spreadsheets seized as part of Operation Apparel demonstrates that Expeditors was not named in those documents. While Ms Goldring's submissions to the effect that an orchestrated fraud could not work without every component in the chain knowing the role it had to play have an undoubted logic to them, they involved her speculating on the possible motives of fraudsters and, for obvious reasons, we had no evidence from the fraudsters themselves as to whether the speculation was warranted. Given that brokers were evidently not routinely named in the Diaries, it is equally possible to speculate that the fraudsters preferred to use unwitting brokers (who might be presumed to be more likely to secure the VAT refund) and had a means of manipulating their purchases and sales.

174. Therefore, the fact that the transactions were orchestrated is not, <u>of itself</u>, a particularly strong indicator that Expeditors <u>knew</u> of the orchestration. However, as we will note later in this decision when we deal with Expeditors' argument that it was the innocent dupe of MTIC fraudsters, the inference of knowledge in this case is much stronger given, among other matters, the sheer uncommerciality of Expeditors' operations.

175. In a similar vein, Ms Goldring submitted that the fact that Expeditors maintained an account with FCIB, was evidence that Expeditors was a knowing participant in an orchestrated fraud since, it would not otherwise have chosen to maintain an account with an obscure offshore bank (which happened to be used by virtually all other participants in the deal chains). Again, if Expeditors was engaged in normal commercial operations, we would not regard the inference as particularly strong as we consider that, in 2006, FCIB was offering internet banking that enabled customers to have access to banking facilities 24 hours a day which was not generally available

from mainstream "high street" banks. Therefore, a normal commercial trader who chose to open an account with FCIB might simply be taking advantage of a new type of banking facility. However, as we will note later on in the decision, we regard the inference as much stronger in the circumstances of this appeal.

Links between Expeditors and other participators in the arrangements

176. There were links between Expeditors and other participators in the arrangements that went beyond the apparent commercial relationship between them.

177. For example Expeditors, despite having no financial strength, and despite not carrying out any money-lending activity as part of its normal course of business lent Santok £80,000. Moreover, Expeditors chose to take this step shortly after the point at which it became clear that its claims for input tax recovery were subject to extended verification. As we have noted at [109], Mr Howard felt the need to backtrack (in a wholly unconvincing way) from evidence that he had given on the reasons why Expeditors made this loan.

178. In addition, even after being involved in transactions with Santok which resulted in HMRC refusing Expeditors' claim for input tax credit because HMRC considered they were connected with fraud, Mr Howard was prepared to undertake a project for Santok. Mr Howard was not candid in admitting that he had done this work for Santok. His explanation of why he undertook the project was not plausible: if Santok had not repaid the loan Expeditors had made in full, Expeditors' remedy was surely to seek to enforce payment. We do not understand why Mr Howard would agree to work for Santok in order to secure payment of a debt already due to Expeditors.

179. Mr Howard's lack of candour in relation to the work that he did for Santok and the reasons for the loan of £80,000, has caused us to conclude that Mr Howard was seeking to cover up the fact that there was some other improper connection, agreement or understanding between Expeditors and Santok. The existence of the improper relationship between Santok and Expeditors is, in our judgment, a further reason why Expeditors knew specifically that Deals 7 to 10 (in which it was purchasing from Santok) were connected with fraudulent evasion of VAT.

180. We also consider that there was an improper arrangement or understanding between Expeditors and Focal. As noted at [96], Expeditors acquiesced in arrangements that gave a misleading impression of the nature of the relationship between Focal and Expeditors. The loans from Focal were crucial to Expeditors' ability to trade in its chosen market as, without those loans, it could not fund the VAT element of the purchase price it had to pay its suppliers. Those loans did not just finance certain of Expeditors' 10 deals: rather they put Expeditors in a position in which it could do all of those deals. Therefore, Expeditors knew (i) that the loans from Focal were crucial to its ability to transact all 10 deals and (ii) the existence of some wider arrangement meant that the loans from Focal had to be described in a particular, and misleading, way on invoices that Focal issued. In our view, that is itself an indication that Expeditors knew all 10 deals were connected to fraudulent evasion of VAT.

181. Finally, the evidence at [119] demonstrates that LTL's chosen trading partners in the very months that it was dealing with Expeditors in Deals 1 to 6 were predominantly companies who were named in the Diaries and who were, therefore, in all likelihood, dishonest participants in carousel fraud. LTL treated Expeditors generously by offering it "ship on hold" facilities. That raises the inference that LTL regarded Expeditors as a similar kind of counterparty to those named in the Diaries which in turn raises the inference that Expeditors was indeed a similar kind of counterparty and knew full well of the connection between its transactions and fraudulent evasion of VAT.

Inspection, due diligence and verification of VAT registrations with Redhill

182. As we have found at [82] onwards, that there was one occasion on which Expeditors did not have the results of inspection reports before agreeing to ship goods. In addition, Expeditors did not appear to ask questions that it could have done in response to the conclusions of inspection reports that it obtained. On its own, we do not consider that this points strongly towards a conclusion that Expeditors knew, or should have known, that its transactions were connected with fraud. There was only one occasion on which Expeditors gave instructions to ship before having an inspection report. The failure to ask questions about cut-outs could simply be attributable to Mr Howard's failure to read the report sufficiently carefully because he was busy. Similarly, viewed in isolation, the fact that Expeditors entered into transactions before he had received confirmation of VAT registrations from Redhill in some cases is not a particularly strong indicator that it knew, or should have known, of connection with fraud. Isolated instances of this could be explained by oversight or carelessness.

183. However, we are more troubled by the fact that Mr Howard has, both in his evidence, and in documentation that he prepared in 2006, sought to give a misleading impression of the confirmations that he obtained from Redhill. As with the Daily Price Reference Sheets, the fact that, in 2006, Mr Howard decided to create documents that gave a misleading impression of what was happening in his business points strongly to a conclusion that he knew his transactions were connected with fraud.

184. Expeditors have criticised HMRC for not doing more to alert Expeditors to the connection between its transactions and VAT fraud. For example, Expeditors have submitted that HMRC knew that Smart View (the defaulting trader in Deals 4 and 5) had defaulted on its VAT obligations before Expeditors entered into Deals 4 and 5. Expeditors also notes that it had previously provided HMRC with its terms and conditions and samples of the due diligence that it was performing on counterparties and HMRC had expressed no concerns on this material. We do not consider, however, that the state of HMRC's knowledge is relevant. What matters is whether Expeditors knew, or should have known, of the connection between its transactions and fraud.

185. Ms Goldring invited us to conclude that Expeditors' due diligence was mere "window dressing". We will not go as far as that. However, we do consider that the due diligence material provided Mr Howard with further evidence of the sheer

uncommerciality of the transactions with which he was concerned at least in relation to Deals 1 to 6. Mr Howard would have been aware from that due diligence that LTL, Expeditors' supplier in Deals 1 to 6 was, like Expeditors, a company with low financial strength, but was still capable of supplying Expeditors with large quantities of expensive mobile phones. Similarly, Blue Star and Compucell (Expeditors' customers in Deals 1 to 6) had no evident financial strength but were still purchasing large quantities of expensive mobile phones. The fact that Expeditors was in possession of this material but still chose to undertake Deals 1 to 6 is in our view an indication that it knew of connection to fraud.

186. The due diligence on Santok and Sunico (Expeditors' supplier and customer respectively in Deals 7 to 10) indicated that both companies were credit-worthy. Therefore, the inference that we refer to at [185] was not present in Deals 7 to 10.

Expeditors' terms of business

187. Ms Goldring made a number of submissions as to the flimsiness of Expeditors' standard terms and conditions and the fact that they did not reflect the true commercial deal between Expeditors and its customers and suppliers in important respects.

188. As we have noted at [74] to [79], Expeditors' contractual documentation was in some respects defective and did not correspond to the transactions actually undertaken (particularly as regards due date for payment and the absence of a documented "ship on hold" facility). Were Expeditors engaged in normal commercial operations, we would not consider that this factor would support an inference that Expeditors knew, or should have known, that its transactions were connected with fraudulent evasion of VAT. Small and medium sized businesses in many cases operate under standard form contracts that are completely inconsistent with the business they actually conduct. However, given Expeditors' uncommercial operations, and the high value of the transactions it was involved in, we consider that Expeditors' defective contractual documentation suggests that it was aware that the terms on which it contracted did not really matter because goods and money would flow in accordance with the pre-arranged scheme.

Weighing up the inferences – our overall conclusion on knowledge and means of knowledge

189. There is no single piece of evidence that demonstrates, on its own, that Expeditors knew or should have known, that its transactions were connected with fraudulent evasion of VAT. We have therefore approached the question by considering what conclusions can be drawn from the evidence we have. That has involved us weighing up the competing inferences set out at [163] to [188] above.

Whether Expeditors actually knew that its transactions were connected with fraudulent evasion of VAT

190. We have set out a number of inferences that, in our view, point with varying degrees of strength towards the conclusion that Expeditors actually knew its transactions were connected with fraudulent evasion of VAT. In this section, we will consider Expeditors' submission that, at the time it did not know of the connection with fraud because it was the unwitting dupe of the fraudsters who were orchestrating the overall scheme.

191. We are prepared to accept that, in theory, an innocent trader could be manipulated by a criminal orchestrator of an MTIC fraud. For example, a criminal gang could offer particular stock for sale at a certain time and, shortly after, call the trader to enquire about purchasing stock of exactly the same description. The prices offered could be sufficiently attractive for the trader to have a natural wish to buy and sell at those prices. Moreover, if the trader showed signs that it wished to buy from the "right" counterparty but was not going to sell to the "right" counterparty (which would result in the fraudster losing control of its goods which it would wish to recirculate in further carousel fraud), the fraudster might simply renege on its offer to sell. Similarly, if the trader showed signs of wishing to sell to the "right" counterparty goods that it had purchased from the "wrong" counterparty (which would result in the fraudster's money passing outside the chain of orchestrated transactions), the fraudster could renege on its offer to purchase.

192. However, the question is not whether it is possible in theory for innocent traders to be manipulated. Rather, the question is whether Expeditors was itself an innocent trader who was so manipulated. Having weighed up all the evidence, we have reached a clear conclusion that it is much more likely that Expeditors knew of the connection to fraud. Put shortly, the possibility that Expeditors was an innocent dupe is outweighed by inferences that it knew full well of the connection to fraud. Although we regard all of the inferences referred to at [163] to [188] as important to this conclusion, we think that it is particularly important to note that Expeditors knew that it was not engaged in any normal commercial enterprise. We also think that it is significant that Mr Howard has chosen to give untrue evidence to the Tribunal in relation to the Daily Price Reference Sheets and the scope of the VAT confirmations he received from Redhill. The fact that he gave that untrue evidence strongly suggests that he wished to divert attention from the true position (namely that Expeditors knew of the connection with fraud). Moreover, as we have found, even in 2006, Mr Howard was recording that he had received confirmations from Redhill that had not been received and was preparing Daily Price Reference Sheets which sought to disguise the lack of commerciality associated with Expeditors' business. That supports the conclusion that, at the time of Expeditors' transactions, Expeditors knew they were connected to fraud.

193. Similarly, we acknowledge that an innocent trader in 2006 might have had good reasons for wanting to bank with FCIB given the strength of its internet banking offering. However, the inference that Expeditors selected FCIB for good commercial reasons is more than outweighed by the factors set out above which suggest that Expeditors knew, from some channel or other, that maintaining an account at FCIB

would enable funds associated with its uncommercial transactions to move rapidly between the large number of traders contained in its deal chains.

194. Finally, we have noted that, for reasons we have given earlier in this decision, we did not find Mr Howard to be a reliable witness and we have concluded that there were occasions on which his evidence was untrue and occasions on which it was misleading or less than candid. That is a further reason why have not accepted Expeditors' argument that it was the unwitting and innocent dupe of MTIC fraudsters.

195. Our overall conclusion is that HMRC have demonstrated to our satisfaction that Expeditors knew that all of its 10 transactions were connected with the fraudulent evasion of VAT.

Whether we should make additional findings on knowledge

196. Ms Goldring invited us to conclude that Mr Howard (and so Expeditors) were dishonest. As the recent decision of the Upper Tribunal in *E Buyer UK Limited v HMRC* and *HMRC v Citibank NA* [2016] UKUT 0123 (TCC) has demonstrated, an allegation that a taxpayer knew that its transactions were connected with fraud (in the *Kittel* sense) is not necessarily an allegation of fraud in itself. We were satisfied that HMRC's Statement of Case set out a positive allegation of fraud. Moreover, allegations of fraud were specifically put to Mr Howard in cross-examination. We therefore consider that it would be open to us to find that Mr Howard and Expeditors were dishonest. There was certainly evidence in front of us that was consistent with dishonesty.

197. However, our finding at [195] is sufficient to dispose of this appeal and we do not see any reason to make additional findings.

Whether Expeditors "should have known" that its transactions were connected with fraud

198. Even if we had not concluded that Expeditors knew that its transactions were connected with fraudulent evasion of VAT, we would have concluded that it should have known of that connection.

199. A reasonable businessman trading wholesale in mobile phones would have been well aware of the prevalence of MTIC fraud in that industry not least since HMRC took steps to inform industry participants of that fact in Notice 726 and other communications. A reasonable businessman would have noticed that all 10 transactions in this appeal were lacking in ordinary commerciality. Those transactions enabled Expeditors to make significant profits despite having no capital and despite the fact that it added no value to the phones it acquired. Expeditors obtained the funding it needed to do the transactions on the flimsiest of terms from lenders who did not behave like ordinary arm's length lenders. The only reasonable explanation for those transactions, which were being carried out in an industry in which fraud was rife, and their surrounding circumstances was that they were all connected with fraudulent evasion of VAT.

Conclusion

200. Our conclusion is that the appeal is dismissed. We understand that both parties are agreed that the Tribunal has power to award costs in this case. We therefore direct that Expeditors must pay HMRC their costs of this appeal with such costs to be assessed, on the standard basis, by the Senior Courts Costs Office if the parties cannot agree the amount payable.

201. 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.

JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 5 DECEMBER 2016

APPENDIX – PARTIES REFERRED TO AND DEFINED TERMS USED

Party/Defined Term	Description
3G	3G Mobile Phones Limited, a company from whom Expeditors received commission in 2005
A1 Inspections	A1 Inspections Limited, the company that performed inspections of stock for Expeditors
Blue Star	Blue Star Telecom APS, incorporated in Denmark, and Expeditors' customer in Deals 1, 4, 5 and 6
Compucell	Compucell BV, incorporated in the Netherlands, and Expeditors' customer in Deals 2 and 3
Focal	Focal Computers Limited, a company of which Marcus Walton was a director, which lent money to Expeditors
FCIB	First Curacao International Bank, through which payments relating to all deals but one were made
Hawk	Hawk Precision Logistics Limited, a freight forwarder that Expeditors used
LTL	LTL Communications Limited, Expeditors' supplier in Deals 1 to 6
Santok	Santok Enterprises Limited, Expeditors' supplier in Deals 7 to 10. Also made loans to, and received loans from, Expeditors
Sunico	Sunico A/S, incorporated in Denmark and Expeditors' customer in Deals 7 to 10.
Unique	Unique Distribution Limited, where Mr Howard worked before leaving to set up Expeditors