TC00410

VAT – MTIC fraud – appeal originally substantially allowed – on appeal to High Court referred back to original tribunal for reconsideration in light of recent High Court decisions – original decision confirmed

FIRST-TIER TRIBUNAL (TAX CHAMBER)

BRAYFAL LTD **Appellant**

- and -

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

Tribunal: **David Demack (Judge)**
Arthur Brown FCA CTA (Member)
Peter Whitehead (Member)

Sitting in public in Manchester on 28 July 2009 and 8 September 2009

Michael Patchett-Joyce of counsel instructed by the Khan Partnership, solicitors, London, for the Appellant

John Black QC leading Jonathan Cannan instructed by the General Counsel and Solicitor to Her Majesty's Revenue and Customs for the Respondents

DECISION

Introduction

1. This decision is supplemental to that released on 22 August 2008 under reference (2008) Decision No. 20781 and should be read therewith. All references in this decision to paragraph numbers without more are to that decision.

2. The appellant company, Brayfal Ltd ("Brayfal"), appealed against a decision of the Commissioners given on 20 April 2007 refusing its claims for repayment of input tax of £1,085,654, for periods 03/06 and 05/06. The repayments were refused because in the opinion of the Commissioners Brayfal's transactions were connected with the fraudulent evasion of VAT. Brayfal maintains that it did not know and had no means of knowing that its transactions were connected with such evasion.

3. The appeal is concerned with what is known as Missing Trader Intra-Community ("MTIC") fraud, the nature of which has been described in a number of judgments including those of *The Commissioners for Revenue and Customs v Livewire Telecom Ltd* and *Olympia Technology Ltd v The Commissioners for Revenue and Customs* [2009] STC 643, *Blue Sphere Global Ltd v The Commissioners for Revenue and Customs* [2009] STC 2239 and *Red 12 Trading Ltd v The Commissioners of Revenue and Customs* (CH/2009/APP/0102). In its simplest form, the fraud involves an importer of goods into the UK selling them on to a UK trader and failing dishonestly to account for the output tax on the onward sale. The form of the fraud involved in the instant case is that known as "contra-trading", which is explained at paragraphs 9 and 10 of the judgment of Burton J in *R v Just Fabulous (UK) Ltd v The Commissioners for Revenue and Customs* [2008] STC 2123. It involves two separate chains of transactions, usually referred to for convenience as the "dirty chain" and the "clean chain", said to be connected by a contra-trader. The contra-trader acts as importer in the clean chain and as broker, i.e. exporter, in the dirty chain. In the instant case the alleged contra-trader was Future Communications Ltd ("Future"). The dirty chain initially follows the form of the simple MTIC fraud just described but ends with the contra-trader exporting the goods tax free but with the right of tax recovery, whilst the clean chain is a device designed to mask or conceal the MTIC fraud, it does not on its face involve any contravention of the law and artificially manufactures an output tax liability against which the input tax claim which might otherwise be refused may be offset. The Commissioners say that Brayfal was the broker in the clean chain. Its customer in all the transactions it completed was Universal Handels GmbH ("Universal"), an Austrian company.

4. We heard the appeal over 24 days in 2007 and 2008 and concluded that Brayfal did not know or have the means of knowledge at the time of its transactions that they were connected to fraudulent tax losses. We therefore allowed its appeal. We did not, however, allow the appeal in its entirety for Brayfal had failed to pay the full

consideration for one of its purchases, so that we reduced its input tax in respect of that purchase under section 26A of the Value Added Tax Act 1994.

5. Our decision in that behalf was appealed to the High Court by the Commissioners, and Brayfal cross-appealed. The case came before Peter Smith J on 27 March 2009. By consent, he ordered that "the matter be remitted to the VAT & Duties Tribunal (Manchester Tribunal Centre), as originally constituted (the Tribunal), to enable the Tribunal to confirm or vary its decision in respect of each of the issues identified in paragraph 5 of its Decision of 22 August 2008 and, in respect of each issue, to give full reasons in support thereof". The order also made provision for each party to lodge further written submissions before the appeal was relisted for further oral submissions. Effectively, the case was remitted to the tribunal to enable it to reconsider the evidence and its conclusion in the light of the High Court judgments in the conjoined cases of *Livewire* and *Olympia* and that of *Blue Sphere*. But since those cases were decided there have been further High Court decisions we must also take into account. They are those in *Mobilx Ltd (in administration) v The Commissioners for Revenue and Customs* [2009] STC 1107, *Calltel Telecom Ltd, Opto Telelinks (Europe) Ltd v The Commissioners for Revenue and Customs* [2009] STC 2164 and *Red 12 Trading Ltd v The Commissioners for Revenue and Customs* [2009] EWHC 2563 (Ch).

6. For convenience, we rehearse the three questions at [5]. They were:

i) Have the Commissioners established fraudulent tax losses in the deal chains of Future Communications Ltd., the alleged contra-trader?
ii) Are the transactions in respect of which Brayfal seeks input tax credit referable to those tax losses?
iii) Did Brayfal through Mr Kibbler [its director] know or have the means of knowledge at the time of entering into its transactions that they were connected to the fraudulent tax losses?

7. In our original decision, we answered the first two of those questions positively, and the third one negatively. It is therefore for us as the first instance tribunal, having ascertained the facts, to decide whether the Commissioners have established that Brayfal did know or had the means of knowing that it was participating in transactions connected with the fraudulent evasion of VAT.

8. As in the earlier hearing Mr Michael Patchett-Joyce of counsel appeared for Brayfal, and Mr John Black QC leading Mr Jonathan Cannan represented the Commissioners.

The law

9. As the Chancellor explained in his judgment in *Blue Sphere*, a contra-trading case not dissimilar to the instant one, the right of a registered trader to deduct input

tax paid by him in respect of the supply of goods or services to him from output tax charged on his own supplies and to pay or be reimbursed the difference arises under both EU law and the Value Added Tax Act 1994 ("the Act"). The Chancellor indicated where the relevant EU provisions were to be found, and that sections 24 to 26 of the Act and reg 29 of the VAT Regulations 1995 contain the domestic provisions for the recovery of input tax. He also noted that notwithstanding the relevant EU provisions, there is nothing in the Act qualifying a registered trader's right to repayment of any excess of input tax over output tax at the end of an accounting period. The right to refuse payment on which the Commissioners frequently rely is based on a series of judgments of the Court of Justice of the European Communities.

10. *Optigen Ltd v Commissioners for Customs and Excise* [2006] Ch 218 is the first important judgment in that series. In that case it was assumed for the purposes of the appeal that there was a carousel fraud. The Commissioners accepted that Optigen was an innocent party to the fraud, it having had no dealings with the missing trader in the deal chain. They accepted that it had had no reason to know that it was doing anything other than buy computer chips in the UK from one company and sell them to another company in another Member State. The Commissioners argued that Optigen was not entitled to the input tax it claimed because a trader, even though itself innocent of either fraud or recklessness, did not have the right to recover input tax on goods which it had sold to a company outside the UK when there was a defaulting trader in the chain of supply. The core of the Commissioners' argument was that transactions of this kind did not constitute economic activities giving rise to right to deduct within the Sixth Directive. The questions referred to the Court sought to ascertain whether a chain of transactions, or a carousel, should be considered as a whole, as submitted by the Commissioners, or each transaction individually, as contended by Optigen. In his opinion, delivered early in 2005, the Advocate-General rejected the Commissioners' argument; so too did the European Court. In its judgment, delivered on 12 January 2006, the Court concluded that each transaction must be considered individually and that "the character of a particular transaction in the chain cannot be altered by earlier or subsequent events".

11. The Court's reservations and limitations in *Optigen* were developed into affirmative principles in *Kittel v Belgium* and *Belgium v Recolta Recycling SPRL* (Joined cases C-439/04 and C-440/04 [2008] STC 1537, where judgment was delivered on 6 July 2006. There the questions posited "a recipient of a supply of goods who has entered into a contract in good faith without knowledge of a fraud committed by the seller". The referring Court also wished to know if the answer of the European Court would be different if the taxable person knew or should have known that by his purchase he was participating in a transaction connected with the fraudulent evasion of VAT. Having reiterated that a trader's right to deduct in respect of a transaction is unaffected by other transactions, whether previous or subsequent, the European Court confirmed at para 51 that "traders who take every precaution which could reasonably be required of them to ensure that their transactions are not

connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT…". The Court then dealt with the converse cases stating, inter alia: a) 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 (para 55); b) 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 the fraudulent evasion of VAT, must be regarded as a participant in that fraud (para 56): that is because in such a situation the taxable person aids the perpetrators of the fraud (para 57). The Court concluded: "**…**where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct." (para 61)

12. Thus in the light of the decisions in *Optigen* and *Kittel* (which have since been described by the European Court as "settled case law", see para 65 of *R (on the application of Teleos and others v Commissioners for Revenue and Customs* [2008] STC 706), the Commissioners have the right to refuse a claimed repayment of input tax if the taxable person knew or should have known or had the means of knowing (those elements, for this purpose, amounting to the same thing) that his transaction was connected with fraud.

13. The tribunal in *Dragon Futures v Commissioners for Revenue and Customs* (2006) Decision No 19831 set out its own version of the test at para 51 of the Court's judgment in *Kittel* and at para [75] of the decision stated: "Where an initial enquiry gives rise to information suggesting the need for further enquiry, the test is reapplied to assess the need for that further enquiry" and, at [74]: "If, on what the taxable person knows after taking into account all actual knowledge and having made all proportionate enquiries, the better view is that there is probably no fraud connected with the transaction, then the taxable person has met the required standard." The tribunal in *Calltel Telecom Ltd v Commissioners for Revenue and Customs* (2007 Decision No 20266) approved this interpretation, describing it as a useful starting point.

14. What is clear from the cases is that the relevant "knowledge" is not necessarily knowledge of the actual fraud, or even the identity of a particular defaulter (see the tribunal decision in *Calltel* at [51]), but rather knowledge of the probability of fraud and what a trader can infer from matters he knows or reasonably could know. That was confirmed by Lewison J in *Livewire*. At [91] he determined that an appellant does not have to know (or have the means of knowing) of the identity of the missing trader: the test is that, having taken all reasonable steps in the circumstances, the ordinary competent trader should have known that there was, or was likely to be, a missing trader:

> "The honest trader knows that he has bought goods on which he has paid VAT. He knows that he will export these goods and reclaim the VAT from HMRC. Unless there is a missing trader somewhere further down the chain (or in a parallel chain) there is no fraud. I accept that the honest trader need not know the identity of the missing trader but unless he knows or should have known that there was (or was likely to be) a missing trader somewhere in the dirty chain, I do not see how it can be said that he knew or should have known that his transaction was connected with fraud."

15. Although Lewison J referred to a "missing trader", it must follow that he was including in that description any fraudulent default, whether strictly a missing trader or a hijacked VAT number, or in any other way an intent dishonestly to default in payment of the VAT due.

16. We note that in *Livewire,* Lewison J used the phrase "or was likely to be" in dealing with a missing trader; and in *Mobilx* Floyd J concluded his judgment by saying at [88] that the appellant in that case "should have known that all its transactions were more likely than not to be implicated in MTIC fraud."

17. The judgment in *Mobilx* was delivered subsequent to that in *Livewire*. At [7] of *Mobilx*, in reference to *Kittel*, Floyd J said:

> "In the light of making enquiries beyond the immediate supplier, there is a danger in reading paragraph 51 of *Kittel* in a narrow sense and suggesting that provided proper checks are carried out by the trader on a supplier, then the trader's claims to repayment of VAT are not capable of challenge. That is not, in my judgment, a correct view. Suspicious indications obtained by a trader from carrying out due diligence checks on its supplier are one, but not the only basis from which it may properly be inferred that a trader knew or should have known of its implication in VAT fraud. The test to be applied is that set out in paragraph 61 of the judgment, and indeed in the Court's final determination at the end of the judgment. Paragraph 51 needs to be understood in the sense that 'all reasonable precautions' may, in some cases involve ceasing to trade in specified goods in a particular market, at least in the particular manner in which the trader undertakes that trade. Such a situation may conceivably arise where, from other indications available to the trader, the trader knew or should have known that it is more likely than not that, despite all due diligence checking, any further goods traded in the same way will be implicated in VAT fraud."

18. At [9] of *Calltel* Floyd J observed that in *Livewire* Lewison J "has analysed subsequent decisions of the [European] Court of Justice, which have expressed the test enunciated at [61] in *Kittel* in modified language. For example he drew attention to the fact that in the more recent decision in *Netto Supermarkt GmbH & Co OHG v Finanzamt Malchin* [2008] STC 3280, the Court held at [24] that:

> '…it is not contrary to Community law to require the supplier to take every step which could reasonably be required of him to satisfy himself that the transaction which he is effecting does not result in his participation in tax evasion.'"

19. The European Court in *Teleos*, having formulated the test identically to that in *Netto* (see para 65 of the judgment), then said:

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

20. Lewison J considered those three factors as "cumulative rather than alternative" and observed at para 71 of his judgment in *Livewire*:

> "…it is also notable that the ECJ did not simply say that a supplier who acted in good faith cannot be deprived of the right to deduct: they added the proviso that he must have taken every reasonable measure to ensure that his supply did not lead to his participation in VAT evasion. This underscrores the impression given by paragraph 66 that the factors mentioned in that paragraph are cumulative."

21. At para 69 of *Livewire*, Lewison J drew attention to the difference between "participating in a transaction connected with fraudulent evasion of VAT" (in the *Kittel* words) and effecting a "transaction which … result[s] in his participation in tax evasion" (to use the *Netto* words), and concluded that this had resulted in a narrowing of the test. In *Blue Sphere*, at [25] the Chancellor concluded that "the verbal formulations in *Teleos* and *Netto* [which were identical] did, as a matter of English, narrow the formulation of the principle of *Kittel* as expressed in paragraphs 56 to 59 in *Kittel"*, but went on to say, "But I do not think that the test has, as a matter of law, been narrowed".

22. Brayfal involves an allegation that its deals were connected to a fraudulent tax loss through contra traders, so that the input tax repayment claim was shifted from deals in the clean chain involving purchases from Future with onward sales to Universal were connected to fraudulent losses in dirty chains involving Future as contra-trader and defaulters C&B Trading and Wade Tech. The Commissioners do not suggest that Brayfal was a dishonest co-conspirator. In *Livewire* Lewison J considered the means of knowledge test in such cases:

> "102. In my judgment in a case of alleged contra-trading where the taxable person claiming repayment of input tax is not himself a dishonest co-conspirator, there are two potential frauds:
>
> i) The dishonest failure to account for VAT by the defaulter or missing trader in the dirty chain; and

ii) The dishonest cover up of that fraud by the contra-trader.

103. Thus it must be established that the taxable person knew or should have known of a connection between his own transaction and at least one of those frauds. I do not consider that it is necessary that he knew or should have known of a connection between his own transaction and both of these frauds. If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know. As Millett J put it in *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 295 (in the context of dishonest assistance in a breach of trust):

> 'In my judgment, however, it is no answer for a man charged with having knowingly assisted in a fraudulent and dishonest scheme to say that he thought it was "only" a breach of exchange control or "only" a case of tax evasion. It is not necessary that he should have been aware of the precise nature of the fraud or even of the identity of its victim. A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party, takes the risk that they are part of a fraud practised on that party.'

104. This conclusion is, I think, consistent with what Burton J said in *Just Fabulous*: 'whether or not Evolution [the person equivalent to Brayfal] knew of the precise nature of the defaulter chain or of the goods purportedly dealt with in that chain or the identities of the participants in that chain Evolution *knew of the fraudulent aim of Blackstar* [Future] in acquiring through the off-set on the contra-trading transaction, the opportunity to receive, by such off-set, VAT which it would not be able to recover direct from the Revenue.' (Emphasis added)

105. In other words, if the taxable person knew of the fraudulent purpose of the contra-trader, whether he had knowledge of the dirty chain does not matter."

23. The "connection" referred to in [103] of the *Livewire* judgment was dealt with by the Chancellor in *Blue Sphere* where he explained at [41] that "the connection on which the HMRC relies is the fact that both the clean chains originated with Infinity [the contra-trader] and a large number of the dirty chains ended with Infinity. Thus the connection is through the involvement of Infinity in both and the VAT consequence that it can, indeed must, in the relevant accounting periods set-off its input tax on the dirty chains against its output tax in the clean chains. HMRC accepted … that, on this basis, all traders in a chain in which Infinity was involved must, necessarily, have been connected with fraud. The difference in their treatment depends on the evidence as to their knowledge."

24. The Chancellor continued:

> **"**44. The nature of any particular necessary connection depends upon its context … The relevant context in this case is the scheme for charging and recovering VAT in the member states of the EU. The process of off-setting inputs against outputs in a particular period and accounting for the difference to the relevant revenue authority can connect two or more transactions or chains of transaction in which there is one common party whether or not the commodity sold is the same. If there is a connection in that sense it matters not which transaction or chain came first. Such a connection is entirely consistent with the dicta in *Optigen* and *Kittel* because such connection does not alter the nature of the individual transactions. Nor does it offend against any principle of legal certainty, fiscal neutrality, proportionality or freedom of movement because, by itself, it has no legal effect.
>
> 45. Given that the clean and dirty chains can be regarded as connected with one another, by the same token the clean chain is connected with any fraudulent evasion of VAT in the dirty chain because, in a case of contra-trading, the right to reclaim enjoyed by C [in this case Future] in the dirty chain, which is the counterpart of the obligation of A [the missing trader] to account for input tax paid by B [a buffer], is transferred to E [in this case Brayfal] in the clean chain. Such a transfer is apt [for reasons given by the tribunal in *Olympia*] to conceal the fraud committed by A in the dirty chain in its failure to account for the input tax received from B.
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> 46. Plainly not all persons involved in either chain, although connected, should be liable for any tax loss. The control mechanism lies in the need for either direct participation in the fraud or sufficient knowledge of it. It is important …that the tax losses are only used once."

25. The Chancellor went on to deal with knowledge. The relevant part of his judgment in that behalf reads:

> **"**52. The burden is on HMRC to prove that BSG [the equivalent of Brayfal] ought to have known that by its purchases it was participating in transactions connected with fraudulent evasion of VAT. It is not for BSG to prove that it ought not. Second, it is not sufficient to demonstrate that [the appellant] was involved in transactions which 'might' turn out to have undesirable associations. The relevant knowledge is that [the appellant] ought to have known that by its purchases it was participating in transactions which were connected with the fraudulent evasion of VAT; that such transactions might be so connected is not enough.

> 53. … HMRC must also prove that BSG ought to have known that those other transactions involved the fraudulent evasion of VAT.
> 54. …
> 55. In my view it is an inescapable consequence of contra-trading that for HMRC to refuse a claim by E [here Brayfal] it must be in a position to prove that C [here Future] was party to a conspiracy involving A [the missing trader]."

26. In *Commissioners for Revenue and Customs v Brayfal Ltd* (Unreported) CH/2008/App 082 Lewison J expressed a contrary view in answer to the question dealt with by the Chancellor in [55] above. Christopher Clarke J considered both views at [53] of his judgment in *Red 12*, and said that had it been necessary in that case to reach a conclusion on the question, he would have been in agreement with the Chancellor.

27. In his judgment in *Just Fabulous*, Burton J had this to say about contra-trading where it was not alleged that the appellant was a co-conspirator with the contra-trader;

> "29. … there are bound to be evidential difficulties with regard to precisely what needs to be proved in respect of what might loosely be described as *mens rea* - 'knew or should have known' (see *Kittel* para 56), as contrasted with 'having no knowledge and no means of knowledge' (see *Bond House* para 46) – and the extent to which such *mens rea* must be proved."

28. He returned to this question at the end of his judgment, saying:

> "55. The assumed facts [in Just Fabulous all the facts were assumed to have been found against the appellants] ... put the case at the highest against these claimants; but of course there may well be gradations of knowledge which would need to be considered by the tribunal …"

29. Burton J also said that the European Court had the Sixth Directive well in mind in expressly permitting the right to refuse/deductions payment (*Kittel* [55], [60] and [61]). That was in addition to his observation at [45] of *Just Fabulous* that "The [European] principle of legal certainty must be trumped by the 'objective recognised and encouraged by the Sixth Directive … of preventing tax evasion, avoidance and abuse." And, as the Chancellor observed at [21] in *Blue Sphere*, the European Court, in dealing with the question whether innocent suppliers could be required to account for the VAT, considered the principles of legal certainty, proportionality, fiscal neutrality and freedom of movement of goods. (We might usefully mention at this point that Mr Patchett-Joyce submitted that the various judgments of the domestic courts failed to take account of the European principles we have just listed. In the judge's opinion, it is quite plain that the courts have taken full account of those principles, so that we are unable to accept his submission.)

30. At [85] in his judgment in *Livewire*, Lewison J observed that the European Court "was at pains to stress that the test was not one of dishonesty … But it is also evident from the court's statement that a Member State may lawfully impose a requirement on suppliers to take all reasonable precautions in order to preserve their right to deduct …In addition, it seems to me that the proposition that whether a person knew or should have known is to be tested by objective facts or factors". The learned judge considered "the appropriate domestic analogy is that of constructive knowledge or constructive notice", described by Denning J in *Nelson v Larholt* [1948] 1 KB 339 at 343 as follows:

> "He must, I think, be taken to have known what a reasonable man would have known. If, therefore, he knew or is to be taken to have known of the want of authority, as, for instance, if the circumstances were such as to put a reasonable man on inquiry, and he made none, or if he was put off by an answer that would not have satisfied a reasonable man, or, in other words, he was negligent in not perceiving the want of authority, then he is taken to have notice of it."

31. Although the European Court held that a taxable person who had unwittingly been a party to a transaction within a fraudulent chain was nevertheless entitled to reclaim input tax in respect of that transaction, it also said that right was not enjoyed by taxable persons who had either "knowledge" or the "means of knowledge" that the chain comprised one or more transactions that had been "vitiated by fraud".

Section 77A Value Added Tax Act 1994 and the Commissioners' Notice 726

32. Section 18 of the Finance Act 2003 added s 77A to the Value Added Tax Act 1994. It provides that a trader buying mobile phones or CPUs (computer chips) may be held jointly and severally liable with its supplier for any unpaid liability to VAT on them. Section 77A(2) enables the Commissioners to serve a notice on a taxable person to whom a taxable supply has been made where at the time of supply the person supplied knew or had reasonable grounds to suspect that some or all of the VAT payable in respect of that supply, or any previous or subsequent supply of those goods, would go unpaid. The Commissioners' Notice 726 "Joint and several liability", issued in 2003, is that notice. In it MTIC fraud is described as "a systematic criminal attack on the VAT system".

33. At para 2.3 Notice 726 explains why s 77A of the Act was introduced as follows: "The fraud relies heavily on the ability of fraudulent businesses to undertake trade in goods with other businesses that may be either compliant in the fraud, turn a blind eye, or are not sufficiently circumspect about their trading connections. Such action whether it is deliberate participation or unwitting involvement fuels the growth of the fraud." In *Mobilx,* as recorded at [9] of the judgment, the parties agreed that the guidance contained in the Notice was generally "equally applicable to the avoiding of challenges to repayment of VAT". As Floyd J agreed, since we are bound by his

judgment, we now consider the Commissioners' guidance. At [10], the learned judge described the Notice as containing "chilling warnings about the prevalence of MTIC fraud" in the mobile phone market. He also noted that "In several places the document makes it clear that the obligation on the trader is to ensure the integrity of his 'supply chain'." At para 4.5, the Notice recognises the difficulty a trader may have in checking on his supplier, but says nevertheless that "we would expect you to make a judgment on the integrity of your supply chain". The Notice gives examples of factors a trader may wish to consider in establishing the legitimacy of its supplier. They include the type and level of checks carried out to establish that integrity and the action the trader took as a consequence of those checks, aspects of payment arrangements and conditions, and details of the movement of goods involved. Para 8.1 of Notice 726 sets out a number of 'checks you can undertake to help ensure the integrity of your supply chain', including checking the supplier's history in the trade, checking what recourse exists if the goods are not as described, and making reasonable checks to ensure that the goods have not previously been supplied.

34. It is not for the Commissioners to say what checks a trader should carry out to ensure that it does not enter into transactions involved with fraud. As Floyd J said in *Mobilx* at [87], "… the company has to exercise independent judgment, not delegate its judgment to HMRC". The Commissioners refuse to specify what checks should be carried out – "A definitive checklist would merely enable fraudsters to ensure that they can satisfy such a list", Notice 726 para 4.6.

35. Having considered all the relevant case and other law, we then proceed to deal with the three questions before us.

Question 1 – Have the Commissioners established fraudulent tax losses in the deal chains of Future?

36. When buying from traders in the EU, i.e. in clean chains, Future always sold to UK traders, such as Brayfal, which then acted as brokers in sales to other EU traders. Thus the brokers achieved a substantial input tax repayment position. In Future's broker chains when selling to EU traders, i.e. in dirty chains, Future always purchased from UK traders (buffers) who had earlier also purchased from other UK traders. To quote Mr Devine, "It was always the same; the clean chain or the dirty chain."

37. Each VAT accounting period, Future "netted off" its acquisition and broker deals to reduce its VAT liability in them to virtually nothing. Thus in the quarterly period 01/06 on turnover of over £500 million its liability was 91p. In the first month of each quarterly period it completed mainly acquisition deals, and in the remaining two months balancing broker deals (see [76]).

38. At [74] we found as fact that the Commissioners had analysed over 66 per cent of Future's 3281 broker chains covering the first six months of 2006, and all had been

traced back to a UK tax loss. We further found that as at 19 September 2007 tax losses caused by defaulting, missing or hijacked traders in those chains had been identified totaling over £115 million. Having considered at length in [71] to [95] the evidence in relation to Future's transactions and dealings, we also found as a fact, at [94], that Future acted as a contra-trader in an overall scheme to defraud the public revenue. We did so having indicated that, since Future was not a party to the proceedings, we had taken the greatest care in dealing with the evidence relating to it. And we further found at [98] that Brayfal's transactions formed part of that scheme. In so finding, we accepted that the process of allocation of the losses adopted by Mrs Judith Clifford, the Commissioners' assurance officer for Future, had no statutory basis, but was merely a practical means of the Commissioners seeking to avoid the possibility of double recovery. We confirm our finding that the Commissioners have established fraudulent tax losses in the deal chains of Future.

39. In relation to that finding, we should say that we have most carefully considered submissions by Mr Patchett-Joyce to the effect that since no individual officer of the Commissioners could describe the overall scheme to defraud the revenue we should conclude that there was no such scheme, and the Commissioners had not pleaded that there was. We accept that no individual officer could do so, but nevertheless, on the basis of the oral evidence, and particularly that of Mrs Clifford and Mr Simon Devine, the Commissioners' assurance officer for Brayfal, and all the documentary evidence before us as to the transactions involving Brayfal, Future, Universal, and other companies, it appears that there was such a scheme. However, we record that we heard no evidence to show that Brayfal was aware that it was involved in the scheme, and was thus an innocent party.

Question 2 – Are the transactions in respect of which Brayfal seeks input tax credit referable to those tax losses?

40. On the basis of a detailed consideration of Mrs Clifford's evidence as to Future's dealings in general and of Brayfal's transactions with Future in particular, as mentioned in the last preceding paragraph, at [98] we found that Brayfal's transactions were part of an overall scheme to defraud the public revenue in which Future acted as a contra-trader, despite Brayfal being made unaware of it. We found as a fact that Brayfal's transactions were part of the scheme, and were thus referable to the fraudulent tax losses in Future's deal chains. As mentioned in the last preceding paragraph, we heard no evidence to prove that Brayfal was aware of its involvement in the scheme.

Question 3 – Did Brayfal through Mr Kibbler know or have the means of knowledge at the time of entering into its transactions that they were connected to the fraudulent tax losses?

Introduction

41. Before proceeding to answer question 3, there are two matters we must mention. They are, first, the fact that despite the tribunal having received evidence during the first few days of the hearing from Mrs Clifford that Future was allegedly one of the biggest contra-traders the Commissioners had encountered, yet it had been allowed to continue trading, and was indeed still trading at that time (see [72]). Secondly, there is the matter of Mrs Clifford's evidence about the assessment including the tax loss attributed to C & B (see [85]).

42. As to the former matter, no information whatsoever was provided. The Commissioners offered no evidence as to why this was allowed to happen. We might disclose that Future continuing to trade when the hearing started was deemed relevant to the approach of the members to question 3.

43. In relation to the latter matter, Mrs Clifford did eventually correct her evidence. We were provided with full details of Future's invoices against which she set Brayfal's input tax claims, and she was cross-examined in detail thereon by Mr Patchett-Joyce, those instructing him having earlier been supplied with all the documentation they required from the Commissioners as to the extent of the related deal chains. In those circumstances, although Mrs Clifford's initial error was grave, her incorrect evidence made no difference to the outcome of the appeal.

44. We turn then to consider our approach to question 3. At paragraph 111 of his judgment in Red 12 Trading, Christopher Clarke J said this:

> " … 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."

45. In reaching its own decision as to the answer to question 3, in *Blue Sphere Global Ltd v Commissioners for Revenue and Customs* (2008) UK VAT 20901 at [152], the tribunal found it helpful to adopt the approach taken in the direct tax case of *Hall (Inspector of Taxes) v Lorimer* [1992] STC 599 by Mummery J at 612 and subsequently approved by Nolan LJ [1994] STC 23 at 29:

> "The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details may

also vary in importance from one situation to another. The process involves painting a picture in each individual case."

46. The tribunal continued: "Individual factors may be insufficient in themselves to lead to a conclusion that a trader 'should have known', but the accumulation of a whole series of such factors may prove to be of such weight that, on the evidence before a tribunal, this can be the only conclusion."

47. Although we intend to proceed on the same basis as did the Blue Sphere tribunal, we should record that the members say that, whilst taking account of all the evidence, certain aspects of it relating to the completed deals entered into by Brayfal are of less importance than others whereas, since the supplier must have taken every reasonable measure to avoid participation in fraud (see *Livewire* at [85]), the judge takes the view that the tribunal must deal with the entirety of that evidence. The whole tribunal also considers it necessary to look at certain evidence relating to three cancelled deals, and one in which Brayfal failed to pay the VAT due on a transaction, but then proceeded to claim it in full as input tax. The members adopt their position as in its completed deals Brayfal dealt with its one supplier, Future, only on credit terms, and with its one customer, Universal, only on cash terms. Since this gives rise to some fundamental differences between the judge and the members, we record those differences in this part of our decision; we leave lesser matters and those which arise from consideration of the overall effect to our conclusion.

General matters

48. Mr Kibbler, through his company Brayfal, started dealing in the wholesale market in mobile phones in or around 1987, and continued to so until 2006 when, he claimed, the Commissioners' action in submitting the input tax claims under appeal to extended verification caused him to close down his business. As we pointed out at [63], extended verification may have affected Brayfal's ability to continue trading in the longer term, but for the reasons we gave, particularly that of the company trading on credit, we rejected Mr Kibbler's claim as untrue and found that it did not affect its ability to continue trading in June 2006.

49. Mr Kibbler had a wealth of knowledge and experience of mobile phone products and their marketing. He knew about MTIC fraud (see [29] and [30]), and would have been expected to recognise indicators of it and take reasonable steps to guard against it. Brayfal's input tax claim for period 01/03 had been refused by the Commissioners because the export transactions giving rise to its claim were allegedly "non-economic", i.e. they maintained that the company was involved in MTIC fraud. Brayfal appealed against that decision, won his case and the repayment was made by the Commissioners. We shall later deal with that appeal in more detail.

50. As Brayfal was served with Notice 726, Mr Kibbler must be taken to have known that mobile phones had been selected for special treatment and why. He must

also have known that MTIC fraud necessarily involved both a dishonest failure of one trader to account for VAT and a related input tax claim made by a different trader who was an exporter. As Brayfal was such an exporter, he must have recognised that its part in deals might involve it, at least unwittingly, in MTIC fraud.

51. In 2002 the Commissioners agreed with a number of traders in the mobile phone industry a Memorandum of Understanding ("MOU") coupled with a Code of Conduct (see [19]). The MOU contained a recognition by those traders that "VAT fraud involving mobile phones is widespread and growing significantly", and recorded the objective of those traders to co-operate with the Commissioners in reducing the level of VAT fraud by the observance of the Code of Conduct. We listed all the factors the Commissioners requested the traders to consider (but did not require) before supplying stock to a new customer. They included:

- How long have they been trading and do they have any history in the trade?
- Does the customer have sufficient knowledge of the industry to warrant their level of anticipated business?
- Are the goods to be delivered to the country where the customer is resident or are they to be delivered to another country?
- Will the country of destination of your goods be the same as the country that your customer operates in and will payment originate from that country?
- Have you met the customer – if not do you contact them through a third party?
- What knowledge do credit search companies used by you have of the customer?
- Is the customer's bank account in a different town or country to their main business address?

52. Mr Kibbler signed the MOU with two qualifications (see [21]). He said that he would not be recording or retaining IMEI numbers, and reserved the right to deal with European companies maintaining a UK bank account. At the time the Commissioners requested, but did not require, traders to record IMEI numbers to ensure that the goods supplied to them were as invoiced, and to assist them in determining whether their suppliers were part of fraudulent supply chains. Mr Kibbler claimed in evidence that he did not agree to record IMEI numbers as they were not unique to individual phones. That was accepted by the members as fact, but not by the judge (see [23]). That claim differed from the explanation he gave in his witness statement for refusing to record such numbers – that he had reservations about the practicality of scanning and did not issue invoices with IMEI numbers. He did not claim that the expense of scanning was a reason for not recording the numbers. In the event Brayfal did not record IMEI numbers. Its failure to do so exposed it to the risk of dealing with stolen phones, phones which had previously been involved in fraudulent transactions, and goods in which it had previously dealt. The Commissioners treated Mr Kibbler's refusal to record IMEI numbers as a deliberate

attempt to "block" verification of Brayfal's stock, taking the view that he would take action to protect the company only when it could be confirmed that it had been involved in MTIC fraud (see [23]). We should add that no evidence was adduced to show that if Brayfal had recorded IMEI numbers it would have become aware that its transactions were tainted by fraud.

53. From 2002 until Brayfal adopted new working procedures relating to due diligence on 15 January 2006, its recommended checks followed the lines suggested in the MOU. From the latter date they took the form set out in full at [24]. We shall deal with a number of the individual checks in the context of Brayfal's dealings with Future and Universal, but there are two points we should make on the remainder. First, we observe that Brayfal claimed to check all prospective customers' and suppliers' VAT numbers and addresses with the Commissioners' national helpline. The helpline will check an address disclosed by an applicant for information, but will not itself disclose an address. Secondly, it claimed to check that VAT registrations were for the appropriate classification. Neither the helpline nor the European Commission site used by Brayfal offers that service.

54. We recorded that Mr Kibbler "demanded" that Brayfal's input tax claims be processed without extended verification where the checks determined by him to be appropriate were carried out (at [28]). Mr Kibbler was well aware of the reasons for requiring due diligence, and in particular the risk that dealings with other parties might turn out to involve factors inappropriate to purely bona fide commercial transactions.

55. Mr Kibbler claimed that he could not check the integrity of Brayfal's supply chains as he had no means of checking anyone other than Brayfal's own suppliers and customers, adding that if anything had been wrong he would have expected Hawk Precision Logistics Ltd ("Hawk"), Brayfal's freight forwarder, to draw his attention to it (see [57]). Mr Kibbler took no steps to check whether the goods supplied to Brayfal, and which it then proceeded to sell on, had previously been supplied to it, had been stolen, or had previously been involved in fraudulent transactions.

56. Despite the high value of the goods in which it was dealing – its deals were measured in millions of pounds - Brayfal did not enter into formal written contracts with its suppliers and customers, nor did it enter into contracts with clearly defined terms and conditions (see [54]). We found its own terms and conditions as stated on its invoices to differ from those of its suppliers and customers as stated in their own documents (see [52]). As Mr Munro, the other director of Brayfal who advised Mr Kibbler on matters of due diligence, is a barrister and former solicitor, we should have expected him to have ensured that Brayfal's terms and conditions of trade were clear and concise and that there was no doubt that they applied to each transaction; he did not do so. We concluded at [25] that "Brayfal undertook only such checks as it considered necessary to deal with its customers on cash terms, and that Mr Kibbler may have relied on his experience as a businessman to a greater extent than was

warranted in the circumstances". Further, Mr Kibbler accepted that there was no credit agreement in place between Future and Brayfal, although all business between them was carried out on that basis.

57. As Floyd J explained at [23] of *Calltel*, "HMRC operated a verification unit at their office in Redhill. It acted as a means by which a trader might verify that another trader with whom it intended to deal had a valid VAT registration, and that other basic details, particularly name and address, provided by the intended counterparty matched those held by HM Customs and Excise, and latterly HMRC within their own records." When one of the Commissioners' officers visited Brayfal on 29 October 2003, he or she advised Mr Kibbler to use the Redhill office for verification purposes. He refused to do so, claiming that Redhill's response to requests about traders was too slow, and on one occasion had produced an adverse response on Brayfal itself (see [26]). Instead, he used the Europa service provided by the European Commission and the Commissioners' national helpline. As we have already explained, those two sources supply a minimum of information to enquirers. Mr Kibbler claimed never to have received a "veto" letter from the Commissioners (see [27]). We do not find that surprising; such letters are sent only to those using the Redhill facilities. As part of that claim, Mr Kibbler maintained that Brayfal always dealt with honest traders. If he did so he may not have achieved his objective. He clearly ignored the advice offered to him.

58. On 23 March 2004 the Commissioners wrote to Brayfal stating that its 02/04 repayment had been "suspended" whilst the Commissioners undertook checks on the genuineness of the transactions undertaken. The repayment was eventually made. Mr Kibbler acted on the letter and ceased trading with the supplier concerned (see [30]).

59. In evidence, Mr Munro said, "I actually formed the personal view that probably by 2006 reported instances of fraud seemed to have reduced". As early as 2004, in a report to Mr Kibbler on Future (see [34] of our first decision and [64] below), he said, "It may well be that fraud has become less commonplace than in the past …". An indicator that the opposite was indeed the case, and the situation had become worse – an indicator of which Mr Munro must have been aware – was the fact that in 2005 NatWest Bank, with which Brayfal had banked since 1987, had closed its account and those of all other wholesalers of mobile phones on the recommendation of the Commissioners (see [31]). Brayfal then found it impossible to open an account with any other high street bank (again see [31]), but obtained banking facilities from the Allied Irish Bank and Whiteaway Laidlaw Bank.

60. The success or otherwise of Brayfal's input tax claim for period 01/03 (see [45] above) depended on the outcome of *Optigen.* As we earlier explained, in *Optigen* there was assumed to be a carousel fraud to which it was an innocent party. It had had no dealings with the "missing" trader. However, the Commissioners maintained that its transactions were devoid of economic substance and outside the scope of the Sixth Directive. In his opinion, delivered early in 2005, the Advocate-

General rejected the Commissioners' argument. So too did the European Court in its judgment of 12 January 2006. In *Livewire*, Lewison J said at [44]:

> "It was this decision [*Optigen*] that introduced the phrase 'no knowledge or means of knowledge'. It is HMRC's belief that by concentrating attention on each individual transaction in a chain rather than on the totality of the chain the Court gave, if not the green light, then at least the flashing amber light to MTIC fraud, which increased in prevalence thereafter".

61. Following the *Optigen* judgment, Brayfal's input tax claim for period 01/03 was met. On the basis of the evidence adduced relating to Brayfal's input tax claim for period 01/06 we find that Brayfal started trading with Universal within days of that judgment being delivered. And, although not itself a fraudster, Brayfal acted on what Mr Kibbler clearly assumed to be the "green light" for such persons identified by Lewison J in *Livewire*.

62. Brayfal moved back into the wholesale export of mobile phones in 2005, having turned over £27 million in the year to October 2005.

Future

63. Before commencing trading with Future, the alleged contra-trader and Brayfal's only supplier in relation to the completed deals, Mr Kibbler made various enquiries about that company. A Companies House search made in October 2004 (and repeated in August 2005), when such trading commenced, showed that Future had been incorporated on 30 April 2001, and VAT registered on 19 March 2002 (see [71]).

64. Mr Munro was instructed to prepare a due diligence report on Future (see [34]). It was to be based solely on information provided by Mr Kibbler. Mr Munro's instructions were lost. His report, dated 12 October 2004 (see [34]), concluded by saying, "Subject to the usual levels of due diligence being maintained there appears to be no reason why Brayfal should not trade with this company". Mr Kibbler accepted and acted on the report which took no account of Future's short trading history, its issued share capital of £1, net book assets in 2004 of a mere £8,000, and the exponential increase in its turnover in 3 years. In the year to 30 April 2003 the turnover was £1.1 million, in the following year £52.6 million, and in its quarterly accounting periods ended on 31 January 2006 and 30 April 2006 reached over £500 million and £1 billion respectively. The report was prepared on the basis of "abbreviated accounts" containing, according to Mr Munro, "very little detail".

65. Although Brayfal's own due diligence checks were said to include the obtaining of trade references "whenever possible", (see [24] at item 6 of Brayfal's working procedures entitled "New suppliers and purchasers"), Mr Kibbler made plain that, even where he bothered to take them up, he ignored them, saying, "I've never

seen a bad one yet" (see [25]). He also claimed to have obtained an oral trade reference on Future from Hawk, but when, and in what circumstances, he was unable to say.

66. Mr Kibbler paid periodic visits to Future's premises. He also checked its VAT registration, but only on 13 December 2005 and 9 February 2006. In evidence, he claimed to have checked the registration number before alternate deals. We rejected that claim as untrue (see [25]). It is noteworthy that neither of the two checks on Future's registration covered the period with which the appeal is concerned. We accept that had Brayfal made checks on the VAT registration before each deal, it would have been confirmed as valid.

67. Brayfal's working procedures further required a "full goods inspection" (see [24] at item 3 of "Additional and ongoing checks"), Mr Kibbler explaining that as a 100 per cent box count and checks on the contents of "20 per cent of boxes, plus a sample check for SIM locked products". Hawk was instructed to carry out inspections on those terms. We accept that the sample examination explained by Mr Kibbler was adequate for this purpose.

68. Brayfal was invoiced and paid for generic insurance cover on goods it invoiced to Universal under an arrangement said to have been made by Hawk as agent for suppliers. Any such cover was not specific to any of Brayfal's deals. Cover was said to be arranged through a Hawk related company in Dubai. The Commissioners requested copies of the insurance documentation. Brayfal never produced it. Consequently, the Commissioners questioned whether goods exported were insured and, if they were, whether they were covered for their full value. They also observed that it made no sense for Hawk to deal with an insurer based in Dubai rather than the UK.

69. Mr Kibbler never examined any stock Brayfal was said to have purchased (see [47]), although on occasions he visited Hawk whilst it was holding stock for inspection on its behalf. And whilst documents showing stock checks said to have been made by Hawk were produced, no evidence confirming that the checks were actually carried out was adduced.

70. Brayfal exported some single consignments of goods on more than one CMR. Mr Kibbler claimed that it did so where they were transported on more than one vehicle. In some cases the CMR allocation was made before the vehicles to transport the goods were identified.

71. Brayfal did not enter into written contracts for the purchase of phones from Future. The first of three terms and conditions of trade on Future's invoices stated "Above goods remain the property of Future Communications (UK) Ltd until full and final payment is received in cleared funds" (see [52]). Brayfal did not make payment for goods shipped prior to payment until it was itself paid. In those circumstances,

ownership of the goods would have remained with Future until payment. Yet Mr Kibbler claimed that " once Brayfal had confirmed that the goods were those for which the purchase order made provision" the contract for their purchase "was deemed to have been completed with the supplier and the goods belong to Brayfal" (see [53]). His claim in that behalf was unsupported by any evidence. In its absence we find that the goods remained in Future's ownership. Nor was evidence adduced to show that in those circumstances Brayfal's dealings with the goods were authorised.

72. Mr Kibbler stated that Future "purchased direct from the official manufacturers in Europe" (see [18]). No evidence was adduced to show that Future was dealing direct with any phone manufacturer, or for that matter with any authorised distributor. Further, Mr Kibbler claimed that Brayfal traded as near as possible to manufacturers and authorised dealers to ensure that Brayfal was not involved in fraud. Again, no evidence was adduced to support the claim. The evidence showed, and we find, that Future did not purchase direct from manufacturers or official distributors.

73. In a note prepared following his first visit to Future, Mr Kibbler said that Future owned all its stock, and funded its purchases with its own money (see [35]). No evidence was adduced in support of either statement.

74. According to Mrs Clifford, Future itself had a very poor record as to due diligence (see [80]). No evidence was adduced to show that it carried out any checks on Brayfal. Mrs. Clifford told us that Future completed sales of stock to traders from which it had earlier bought it, never inspected goods in which it dealt, never insured them, or retained their IMEI numbers. She added (again see [80]) that Future's sales manager informed the Commissioners that the only way in which it could be sure that the goods in which it dealt actually existed was that its customers paid for them.

Universal

75. Brayfal received a "cold" phone call from one Jason Davis on 13 December 2005 introducing his company, Universal. Mr Kibbler's evidence was that in that call Mr Davis satisfied him that he had experience of the mobile phone industry. Universal, an Austrian company based in Vienna, was wholly owned and directed by Mr Davis, an Englishman resident in London. Mr Kibbler stated in evidence that that was the first time he had come across Mr Davis. He later claimed at least to have known him, or of him, earlier as an employee of an airtime provider later taken over by Future. His evidence on the point was inconsistent. No evidence was adduced to show that Mr Kibbler asked Mr Davis why he was dealing through an Austrian company. The point was not put to Mr. Kibbler.

76. Brayfal carried out its first deal with Universal in January 2006, before Mr Kibbler visited it, and was duly paid for its supplies. As part of Brayfal's standard due diligence checks on companies with which it was trading was a requirement that Mr

Kibbler visit their premises. In evidence Mr Kibbler claimed to have intended to visit Universal prior to commencing trade with it, but to have been prevented from doing so by a heavy cold. Notwithstanding that he made the visit as soon as he had recovered from his illness, it is the fact that Brayfal started trading with Universal before he visited it, and before he met Mr Davis.

77. Mr Kibbler travelled to Vienna on 1 February 2006 and met Mr Davis. Whilst there he took six photographs. We set out the content of the photographs at [43] of our earlier decision. None of the photographs contained what Mr Munro said he would expect to see in photographs taken for due diligence purposes, "Substance, real activity, telephones, computers, paperwork, people working there". On not one photograph is there a single person, evidence of any activity whatsoever, or anything to connect Universal with those premises. We observed of the photographs, "It was as if the premises had recently been vacated and their previous occupier had left behind a few unwanted items of furniture". Mr Kibbler explained the photographs as simply providing proof that he had visited Universal. He also said that the one of the main purposes of his visit was "to confirm that the documentation I have received corresponds with what is actually on it".

78. In evidence, Mr Kibbler said that Universal was renting a portion of the building he visited "as and when he needed it".

79. Mr Kibbler obtained no trade references for Universal despite Brayfal's working procedures indicating that he should do so (see [24]).

80. Universal had two bank accounts, one with Erste Bank in Austria, and the other with the First Curaçao Investment Bank ("FCIB") in the Dutch Antilles (see [40]). Universal chose to use the latter to make payments to Brayfal, and did so with Mr Kibbler's agreement but without Mr Munro's knowledge. In evidence, Mr Munro said that Mr Kibbler knew that he, Mr Munro, did not "entirely approve of" FCIB, adding that the "opinion of the authorities was likely to be exactly what you [Mr Black, leading counsel for the Commissioners] have expressed that, if you are using an offshore bank, there has to be some sinister purpose behind it" (see [41]).

81. Universal provided Brayfal with a copy of its VAT certificate. It showed the company to have been registered on 3 December 2003. That contrasted with Universal's introductory letter to Brayfal which said that the company had "over 15 years experience in the telecommunications sector" (see [39]). No evidence was adduced to show that Mr Kibbler carried out any investigation into the discrepancy.

82. Brayfal obtained a credit report on Universal. It showed the company to have capital of 35,000 euros, to have no telephone landline, and to have a "Graydon" credit rating of 8, explained in the report as "an unclassified risk (risk unknown), used on brand new companies as an example" (again see [39]). It also revealed that Mr Davis was the holder of the whole of its capital, and was resident in Ealing, London.

83. Mr Kibbler made no other enquiries into Universal's financial standing; he obtained no accounts or any other documentation, such as bank references, to determine that standing. Nor did he take any steps to ascertain the level of business it proposed to conduct with Brayfal. Mr Kibbler asked no questions about Universal's status or standing in relation to the Austrian VAT system. Whether Mr Kibbler "checked out" Jason Davis with Hawk, as he claimed he "may" have done, was not confirmed by any other evidence.

84. Brayfal's working procedures also stated that, "Checks are undertaken with freight forwarding agents in each case" (see [24] at item 7 of the section of Brayfal's working procedures entitled "New suppliers and purchasers"). Brayfal made no claim to have made any check with Hawk and made no check on Boston Freight, Universal's freight forwarder, Mr Kibbler in evidence refusing to accept that he should have taken up trade references for the latter as it was not his freight forwarder (see [57]).

85. Hawk inspected the goods Brayfal sold to Universal on invoice 3623 on 10 April 2006. It certified that full unrestricted title in the phones sold was in the name of Brayfal, despite Brayfal not having paid for them. On what authority, if any, Hawk did so was not clear. We are not satisfied that Brayfal had title to the phones, so that it would appear that the certification was incorrect, although Hawk would have been unaware of this.

86. Before us, Brayfal relied on no evidence from Universal or Jason Davis. In evidence Mr Kibbler admitted not having checked to see whether Universal remained in business at the time of the hearing.

87. The Code of Conduct also suggested that another such factor was whether the goods were "to be delivered to the country where the customer is resident or …to another country". (again see [19]). The goods which Brayfal supplied were dispatched to Universal's freight forwarder, Boston Freight, in Belgium at Brayfal's expense. The reason for that arrangement advanced by Mr Kibbler was that it was very expensive to transport phones from the UK to Austria. All the goods which Brayfal sold to Universal were transported to Boston Freight.

88. The transactions with which we are concerned were all customer driven. Mr Kibbler's evidence was that he was approached by Universal and requested to supply a specific number of phones of a particular model. He would then contact Future and another, unidentified, trader, to enquire whether either had the quantity of phones sought. In each case Future had that quantity, and once Universal had submitted its purchase order, Brayfal placed its own order with Future. Thus by the time Universal sent its purchase order, Mr Kibbler knew that Brayfal could buy the relevant phones from Future.

89. All the deals were conducted in sterling.

Cancelled deals

90. In the period relevant to the appeal, Brayfal "cancelled" three deals, i.e. on three occasions it placed a purchase order with a supplier but failed to take the transaction beyond that point. Yet in relation to each one it received an invoice from its vendor. No evidence was adduced as to the process of cancellation, but it did emerge, and we find, that Brayfal was the cancelling party. Nor was any evidence adduced to indicate that Brayfal suffered any penalty or any claim for breach of contract as a result of the cancellation of its contracts. We found the circumstances of cancellation to indicate a "lack of commerciality" (see [63]).

91. Two of the cancelled deals were the subject of purchase orders placed in May 2006 (see [63]). On 22 May 2006 Brayfal prepared purchase orders for 3010 Nokia 9500 phones which it faxed to Future on 25 May 2006, its intended purchaser being Elandour, a French company. Future invoiced Brayfal for the full order on 23 May 2006, but the transaction was then cancelled. Mr Kibbler claimed that he felt sure he would have consulted Mr Munro about Elandour and the latter would have prepared a due diligence report on that company. Mr Munro gave no evidence as to being consulted about Brayfal's proposed trade with Elandour, or that he prepared any report. No report was produced in evidence. Mr Kibbler claimed to have visited Elandour in Paris, but produced no site visit report relating to any such trip. Brayfal obtained no trade references or freight forwarders' references on Elandour. Mr Kibbler did, however, check Elandour's VAT number on 3 May 2006 and 31 May 2006. As we mentioned earlier in connection with a claim by Mr Kibbler to have been unable to continue trading through Brayfal in June 2006, he maintained that he had to cancel the deals because Brayfal "was not in a financial position to take delivery of and pay for some of the stock". We repeat that for the reasons we gave at [63], we did not accept that explanation, believing his real reason for the cancellations to be potential losses on future deals in the absence of repayments of input tax by the Commissioners.

92. On the basis of Mr Kibbler's evidence in cross-examination, we found that the deals were cancelled before Brayfal made its VAT return for 05/06 early in June 2006 (it being on monthly returns) (see [66]). Yet in that return Brayfal claimed the input tax on the cancelled deals, not withdrawing the claim until the following January.

93. Further, in documents submitted with Brayfal's 05/06 return the goods the subject of the cancelled orders were described as being "in stock" (see [64]). We found that Brayfal had made arrangements with the Commissioners for goods held over the end of one month into the following one to be so described in such documents, but not goods the purchase orders for which had been cancelled. It did not hold the goods in stock. (It was as a result of Brayfal's declaration that the goods were "in stock", which the Commissioners then thought to be true, that in preparing the

statement of case they ignored the withdrawal of the claims made in January 2007, apparently presuming the withdrawals to have been made in error).

94. In another deal which was cancelled before completion, the invoice for which was dated June 2006, Brayfal placed a purchase order with Infinity Holdings Ltd ("Infinity"). It placed that order with a new supplier, having been informed that Future's directors had been arrested and its documents uplifted by the Commissioners on 1 June 2006. Infinity was another company alleged by the Commissioners to be a contra-trader (see [70]). It had only recently been formed, having been incorporated on 9 June 2004. Mr Kibbler visited Infinity on 17 May 2006 and took a number of photographs, one of which was of Simon Thakor, who had earlier been a director of Infinity but was at that time prevented from holding such office as a result of his having been declared bankrupt in 2004. Nevertheless, he appeared to be in charge of the business. Palkesh Thakor, who had been appointed a director of Infinity at the time Simon Thakor had had to resign his directorship, informed Mr Kibbler that he had no day to day involvement in the running of the company and was a full-time employee of the Alliance & Leicester Bank.

95. Infinity carried out certain due diligence checks on Brayfal, yet Mr Kibbler claimed that no trader had ever done so.

96. Mr Kibbler obtained no trade or credit references from Infinity. He did not check the validity of its VAT registration number until after the purchase order for the proposed deal was placed.

97. The cancellation process was the same as that for the cancelled 05/06 deals. Notwithstanding that cancellation had taken place, Brayfal again made an input tax claim in respect of the tax charged on the invoice it had received, but which it would never pay. That claim was also withdrawn in January 2007. And again, Brayfal incorrectly claimed to hold the goods "in stock".

Unpaid VAT

98. According to Mr Kibbler, Brayfal "mistakenly" failed to pay £200,900 to Future on invoices 5662 and 5663 (see [62]). That sum represented the VAT on the two invoices. As we pointed out in the original decision, if Mr Kibbler's failure to pay had been the mistake he claimed, we should have expected it to be corrected immediately it was found. But despite its having been found, by Mr Kibbler himself according to his evidence, and Brayfal having sold on the goods the subject of the two invoices immediately following their purchase and having been paid in full for them shortly thereafter, the mistaken sum appears still not to have been paid. Future confirmed to Mr Kibbler that it had accounted for the tax on the two transactions. The £200,900 debt was included in the Brayfal's accounts for the year to 31 March 2007 as an "extraordinary item" (see [62]). As we pointed out in the original decision, there was nothing extraordinary about the underpayments; they were perfectly ordinary sums

owed to a creditor. Clearly, Brayfal did not so regard the underpayments. Despite not having paid the VAT on Future's invoices 5662 and 5663, Brayfal included the tax in full in its input tax claim for period 05/06. As the money had not been paid by the date of hearing, we reduced the consideration for the deal by the £200,900 under s.26A of the 1994 Act, and the consequent input tax claim to £170,978.72.

Conclusion

a) The judge's conclusion

99. At the outset of this section of our decision, the judge should disclose that it was with the utmost reluctance, and even then only with a view to unanimity, that he agreed with the members in the original decision that the appeal should be substantially allowed. The tribunal now having had the benefit of the various judgments of the High Court mentioned earlier, and reviewed the whole of the evidence, the judge concludes that the approach to the test of knowledge applied earlier was far too simplistic, was subjective rather than objective, and the test in fact applied, viewed in the light of the later jurisprudence, was incorrect.

100. The test is not one of considering whether Brayfal carried out due diligence to the extent required to deal with a supplier who gave credit for all its purchases, and a purchaser who paid cash for all supplies made to it. Rather it is one of asking whether the Commissioners have established that Brayfal knew or had the means of knowing that it was participating in transactions connected with the fraudulent evasion of VAT (see [12] of this decision), or, to adopt the test as reformulated in *Netto*, of asking whether the supplier has taken every step which could reasonably be required of him to satisfy himself that the transaction he is effecting does not result in his participation in tax evasion. As Floyd J observed at [7] of his judgment in *Mobilx* (see [17] of this decision) suspicious indications from carrying out due diligence are one, but not the only, basis from which it may be inferred that a trader knew or should have known of its implication in VAT fraud.

101. As mentioned at [45] of this decision, the process of reviewing Mr Kibbler's and Brayfal's acts and omissions in relation to the company's deals with Future is one of painting a picture from the evidence presented to the tribunal on which its findings of fact are based. The judge's overall conclusion, based on all the identified deficiencies in Brayfal's due diligence, is that Mr Kibbler did not take every precaution which could reasonably be required of him to ensure that Brayfal's transactions did not involve it in participation in tax evasion. That finding is justification for the judge holding that, applying para 61 of *Kittel*, Mr Kibbler "…knew that, by his purchase, he [i.e. Brayfal] was taking part in a transaction connected with the fraudulent evasion of VAT". The high standard required meant that Brayfal was under a positive duty to take precautions, including the carrying out of due diligence checks when indicators of risk were presented to it. In so deciding, the judge takes account of a considerable number of factors.

102. Mr Kibbler had long experience of the mobile phone industry and its markets, and in 2002 agreed to sign the MOU. In so doing, he agreed to carry out the due diligence requirements of the related Code of Conduct (albeit with exceptions) and, later, adopted Brayfal's own due diligence procedures. In the absence of any corroborative evidence, the Judge is not prepared to accept as true a claim by Mr Kibbler that he was told by the head of the Commissioners' UK tax fraud policy that the MOU "was not worth the paper it was written on". On signing the MOU, Mr. Kibbler refused to accept that he should record IMEI numbers – one reasonable precaution Brayfal might have been expected to take. Mr Kibbler produced internet material indicating that in 2002 some IMEI numbers were duplicated by phone manufacturers, but there was nothing to show that, if duplication occurred at all (the material produced being, at best, anecdotal) it did so other than temporarily; there was nothing to show that it continued in later years, and certainly not into 2006. IMEI numbers are a very, if not the, most important means of the Commissioners being able to prove that phones have been imported and exported more than once, so that a wholesaler's failure to record them removes an essential source of evidence as to their origin, their destination and of the intermediate route(s) they may have taken. In acting as he did, the judge considers Mr Kibbler to have refused to check the integrity of Brayfal's supply chains.

103. In addition to recording IMEI numbers, Mr Kibbler could have enquired of Hawk whether the goods had been imported and, if so, how long they had been in the UK. Neither of those matters would have breached any form of confidentiality. He did not do so: he made no attempt to check the integrity of Brayfal's supply chains.

104. Notwithstanding that the Commissioners did not require mobile phone traders to use the Redhill verification service at the time, Brayfal ought to have done so. The judge considers Mr Kibbler's refusal to do so indicative of at least a somewhat cavalier approach to due diligence.

105. It is a feature of MTIC fraud that all the transactions are carried out in sterling, as was the case with Brayfal's transactions. In itself in the instant case it is a very minor matter, but warrants recording.

106. It was quite plain from Mr Munro's evidence that he regarded MTIC fraud as of historical interest only by 2006 (see [59] of this decision). As Brayfal's adviser on due diligence, he must have conveyed that view to Mr Kibbler, who clearly proceeded to act on it. In doing so, Mr Kibbler ignored the advice offered by the Commissioners to traders likely to become involved in MTIC fraud, particularly that in Notice 726. The judge would include in that "advice" the Commissioners' recommendation in 2005 to the high street banks that they close the accounts of all wholesalers in mobile phones – a recommendation that was acted upon, in Brayfal's case, to its apparent disadvantage. That should have been a clear warning to Brayfal that MTIC fraud continued to be a very serious problem, warranting exceptional care by anyone

dealing in that market. Even had it been belated action by the Commissioners, Brayfal could take no comfort from it.

107. It was no coincidence that Brayfal started trading with Universal within a few days of the *Optigen* judgment being delivered. From Mr Kibbler's evidence, it was plain to the judge that he clearly considered his knowledge of the mobile phone industry and its markets far superior to that of the Commissioners so that he assumed, presumably on the advice of Mr Munro (again see [59] of this decision), that the problem of MTIC fraud was a thing of the past and he could again trade in the wholesale market with a minimum of formalities. The cases which have now gone through the courts and the tribunal clearly reveal that there was an avalanche of what in most cases they have found to be VAT fraud immediately following the release of the *Optigen* judgment, so that Mr Kibbler's assumption was ill founded, and thus cannot be relied upon to support its input tax claim.

108. Brayfal moved back into the export wholesale mobile phone trade sometime late in 2005. Its turnover in the year to 31 October 2005 was £27 million, and there was no suggestion that whatever retail or other type of wholesale trade it was conducting in that year was anything but successful. It returned to exporting against a background of its having had its input tax repayment claim for period 01/03 refused by the Commissioners whilst dealing in that market. In taking such a serious step in an industry rife with fraud, in the judge's judgment, it was essential to check with the Commissioners that it was safe to do so. Mr Kibbler did not so check. Again, the judge can only conclude that he was so convinced of his superior knowledge of the wholesale mobile phone market that, whatever the view of the Commissioners, he believed the possibility of Brayfal becoming a participant in VAT fraud so remote as to be unworthy of his consideration.

109. There is then the question of the terms and conditions on which Brayfal itself traded. As we earlier found, despite the high value of the contracts in which it entered, the company did not do so on written terms, and its own stated terms and conditions of trade differed from those with whom it traded (see [54]). The judge observes that written contracts would deal with matters such as the transfer of title, payment and delivery terms, and address the position in the event of goods proving faulty or being returned. Although the evidence showed that Brayfal had long traded on oral terms, and appeared to have had no problems in doing so, it appears to the judge that familiarity with the practice led to its being treated, if not contemptuously, then with a certain amount of abandon. In view of the high value of the contracts, the judge would have expected Brayfal to have contracted on written terms with all its suppliers and customers. The matter is not critical for present purposes, but to the judge is yet another indicator that Mr Kibbler believed VAT fraud to have been a thing of the past, so that the possibility of Brayfal's being involved in it could safely be ignored.

110. No evidence was adduced of stock ever being returned to Brayfal as damaged or faulty, or of stock being lost or damaged in transit, or during loading or unloading.

The judge considers it unlikely that such events never occurred in consignments as large as those in which Brayfal dealt.

111. Brayfal's relationship with Universal is most revealing and, in the judge's judgment, even considered alone substantially provides the answer to question 3. Brayfal started trading with Universal before Mr Kibbler had visited its premises in Vienna and before he had met Jason Davis. The judge views those facts as a matter of concern and as indicating that Brayfal's due diligence checks were apparently capable of being dispensed with when it suited Mr Kibbler. In other words, Brayfal placed no true reliance on them. In dealing with Universal, Brayfal was trading with an Austrian company about which Mr Kibbler knew nothing, which had an English owner and director resident in London whom he had never previously met and knew nothing of, who was never asked to, and therefore did not, explain why he was trading through a foreign company, was receiving payment for supplies from a bank in the Dutch Antilles, and was delivering the supplies to Belgium. That the goods were delivered to Belgium to keep transport costs down for Brayfal does not affect the fact of their destination. If it was expensive to transport goods from the UK to Austria, it appears rather odd to the judge that an Austrian company should buy goods in the UK. And, if Mr. Davis was in fact trading in Belgium, he should have been asked why he was purchasing goods through an Austrian company. It seems likely, if not more, that Universal should have been VAT registered in Belguim, but there was no evidence that Mr Kibbler thought to check.

112. Payments through a bank based in a country other than that of a trader's residence and delivery to a country other than its residence are included in the MOU as possible indicators of involvement in MTIC fraud. Notwithstanding that the FCIB was a bank properly constituted and authorised by the Netherlands authorities, its base in a country different from that of Universal should have put Brayfal on notice that it might be involved in VAT fraud, so that the situation warranted further enquiry. To that the judge would add that Mr Munro was clearly of the view, and had informed Mr Kibbler, that Brayfal should not receive payments from offshore banks (see [41]). And reading Notice 726 with the MOU, the following signs are also possible indicators of involvement in fraud: that Universal was a recently formed company, although claiming to have a 15 year trading history, had a worthless credit rating, no telephone landline, and occupied premises on a temporary basis, which when later visited as evidenced by photographs taken of them, showed no signs of life. Mr Kibbler also disclosed that visits to customers were made purely to enable him to be able to say that they had been made (see [43]) – a clear indication to the judge that they were made for "window dressing" purposes, and not as part of genuine due diligence.

113. Given the size of the deals entered into between Brayfal and Universal, any company operating with normal commercial caution would have made enquiries as to Universal's VAT status, insisted on production of its accounts and other information as to its financial standing, made enquiries as to the level of business it intended to

conduct with Brayfal, and required confirmation of its business status from at least one, and probably, two referees accepted by the enquirer as reputable. In the absence of accounts and credit checks, Mr Kibbler had no financial information on which Brayfal could have based a decision to trade with Universal. That Universal throughout paid in cash for its purchases from Brayfal does not affect that position. Credit checks carried out in the context of commercial transactions, whether or not such transactions involve cash payments in full before delivery of goods, are valuable independent measures of a company's financial strength, and indicate its ability to conduct legitimate trade on ordinary commercial terms. Further, the checks Brayfal should have carried out were to ensure that it was not involved in transactions connected with, or likely to be connected with, VAT fraud.

114. A customer paying cash is not the only matter a cautious and vigilant vendor of goods should take into account. He will also wish to assure himself that his customer can and will pay before committing himself to a purchase to satisfy that customer's specific order. In the judge's judgment, Brayfal was altogether too eager to place purchase orders with Future for goods required by Universal without having any assurance that it would itself be paid for them. From that he infers that Brayfal knew that it was taking no risk of non-payment by Universal.

115. Coupled with the fact that Universal did not have a telephone landline is Mr Kibbler's statement that the premises were used by Universal "as and when needed". That indicates to the judge that the premises were not part of a permanent base of Universal, and so should have put Mr Kibbler on notice that the company with which he intended to deal might not have been a suitable trading partner.

116. Even if the photographs taken by Mr Kibbler in Vienna on 1 February 2006 were taken over the luncheon break, a matter on which the judge is anything but satisfied, he would have expected them to contain some indications that someone was indeed working there even if it consisted of nothing more than a few papers, files, personal belongings, etc. (Even computer based businesses require some hard copy). But, as we mentioned earlier, none of the photographs contains what Mr Munro said he would have expected to see in photographs taken for due diligence purposes (see [77] of this decision). None contains a single person, any signs of activity whatsoever, or anything to connect Universal to the premises concerned. In the judge's judgment, apart from supporting Mr Kibbler's case that he visited Vienna, the photographs were worthless for due diligence purposes: they were mere "window dressing".

117. One of the photographs shows a number of boxes each clearly capable of storing a number of phones. On each one the word "Nokia" appears. The judge rejects the members' view that that is sufficient evidence of the boxes containing phones. He regards the evidence of a photograph of a box on which a manufacturer's name appears as totally inadequate to prove its contents; he is not satisfied that the boxes contained anything. Further, the tribunal considered it to appear from the photographs that the premises claimed by Universal as those of its business "had recently been

vacated" (see [43]). If they had, the judge considers it most unlikely that boxes full of mobile phones would have been left behind.

118. The judge respectfully disagrees with the members' view that trading in mobile phones in whatever number requires little more than a mobile phone and a fax machine. He accepts that trade in a few dozen mobile phones could be conducted with that equipment, but not where, as in the instant case, the evidence showed Universal's monthly turnover at the time to be in the region of 100 million euros. The judge accepts that the true extent of Universal's turnover would not have been known to Mr Kibbler but, judged even by the size of Brayfal's transactions alone, he must have been aware that it was a very substantial trader.

119. The judge takes the view that Mr Kibbler, as a long established trader in the mobile phone market and with knowledge of the considerable risks of fraud it contained, was much too ready, without a careful and detailed review and the carrying out of exhaustive checks of all aspects of the proposed transactions with Universal, to commit Brayfal to them. When coupled with the remaining factual background as to Brayfal's dealings with Universal, the judge is in no doubt that Mr Kibbler was alerted to what he must have known was Brayfal's almost certain involvement in VAT fraud, and should not have traded with Universal. In the judge's judgment, every item of information Mr Kibbler had about Universal contained its own indicator that trading with that company would draw Brayfal into transactions connected with fraud.

120. The judge then turns to consider Brayfal's involvement with Future. Plainly Brayfal carried out only those due diligence checks that might be required for trade on credit terms between well-established traders with a long record of trust between them. For instance, it made only two checks on Future's VAT registration, not regular checks prior to alternate deals as Mr Kibbler claimed, and both were made outside the period concerned in the appeal. The initial checks Brayfal made on Future, as disclosed in Mr Munro's due diligence report of 12 October 2004 (see [34]) showed the company to have been incorporated in 2001, to have issued capital of £1 and assets of a mere £8,000. Its accounts for the year to 30 April 2004 showed annual turnover to have risen in the year to some £52.5 million from £1.1 million the previous year. Such an exponential increase in turnover should in isolation have constituted a warning sign to Mr Kibbler that he was not dealing with a company engaged in the ordinary commercial market, for no legitimate trader could have experienced such a phenomenal increase in growth in such a short time with the minimal assets Future was shown as possessing. Mr Kibbler did not check, or even attempt to check, the integrity of Brayfal's supply chains, or whether the goods in which it dealt had previously been supplied. Brayfal also failed to make checks it should have made had it complied with the MOU, as later superseded by its own due diligence checks, such as the obtaining of credit references from both its supplier and freight forwarders. Further, Future was willing, without any apparent evidence of carrying out any due diligence on Brayfal, to allow Brayfal to be committed to it in sums exceeding £1 million, and to export goods abroad before requiring payment for

them. In the judge's judgment, no legitimate vendor would have provided Brayfal with mobile phones worth hundreds of thousands of pounds without payment, or the guarantee of payment, knowing that Brayfal would be exporting them to an unidentified foreign country and to an unidentified trader or its freight forwarder; the risk of not receiving payment, or possibly of not seeing the goods ever again, would have simply been enormous and unnecessary.

121. Mr Kibbler must have been aware that Future carried out no due diligence checks on Brayfal for, had it done so, it would have had to approach him for necessary information. The absence of any due diligence checks by Future should have raised suspicions in Mr Kibbler's mind that Brayfal was not involved in ordinary commercial transactions, but rather in transactions into which Brayfal should not have entered without making further enquiries.

122. Although Mr Kibbler claimed that Future traded with manufacturers and/or authorised distributors of phones, the judge saw no evidence to satisfy him that that was in fact the case, or that Brayfal took any real interest in seeing that it was so.

123. Another factor which ought to have raised questions in Mr Kibbler's mind as to whether Brayfal was involved in VAT fraud was the fact that Future always held in stock or was able almost immediately to obtain precisely the number, types and models of phones Universal required. The judge accepts that a large wholesaler would be expected to carry stocks of phones or have ready access to them, but doubts that it would always do so in the quantities in which Brayfal was dealing. The matter is not one of major importance in the context of the entire appeal, but ought to have raised yet one more query in Mr Kibbler's mind as to precisely what Brayfal was involved in.

124. When approached by Universal for goods, Mr Kibbler had no need to contact the other unidentified trader or traders he claimed also to have approached as having goods available for sale, Future always having the required stock available at a price guaranteeing Brayfal a substantial profit, and being willing to provide it on credit terms. In those circumstances, the judge considers it highly unlikely that he did contact any other trader. As Mr Bishopp, the chairman in *Calltel* (2007 Decision No 20266) observed at [52] of the tribunal's decision, a passage cited with approval at [108] by Lewison J in *Livewire*,

> "It is difficult to see how a trader, entering into a chain of transactions in which every trader accounts correctly for VAT (and which is not tainted for some other reason) could have the means of knowing that it is a device for concealing, or avoiding the consequences of discovery of, another, fraudulent, chain of transactions. Nevertheless it is, we think, possible that a trader could have the means of knowing that, by his participation, he is assisting a fraud. Much will depend on the facts, but an obvious example might be the offer of an easy purchase and sale generating a conspicuously generous profit for no evident

reason. A trader receiving such an offer would be well advised to ask why it had been made; if he did not he would be likely to fail the test set out at paragraph 51 of the judgment in *Kittel*."

125. Since Mr Kibbler did not ask why Future made such attractive offers of credit to Brayfal and always had the required goods available for sale, the judge takes the view that Mr Kibbler ought to have made further enquiries to protect Brayfal from the risk of its becoming involved in transactions that might be connected with the fraudulent evasion of VAT. Notwithstanding that Future granted Brayfal credit facilities on all its purchases, Brayfal should have carried out credit checks on its supplier; indeed, it should have gone further and sought additional financial information from Future.

126. At [71] of this decision, the tribunal confirmed that goods for which Brayfal had not paid Future remained in the latter's ownership notwithstanding Mr Kibbler's claim that "once Brayfal had confirmed that the goods were those for which a purchase order made provision", the contract for their purchase was "deemed to have been completed with the supplier and those goods belong to Brayfal…" (see [53]). No-one from Future was called to give evidence to contradict the statement on its invoices that goods remained its property until payment for them had been made in full. Lest there should be any doubt about the correctness of the tribunal's finding, the judge would observe that it defies both logic and commercial reality that Future would relinquish title to goods whilst very substantial sums were due to it for them, or it held no guarantee for payment of such sums. In the judge's judgment, it is yet another piece of compelling evidence that Mr Kibbler must have been aware that Brayfal was involved in uncommercial and contrived transactions.

127. Even if Mr Kibbler's claim that goods belonged to Brayfal once it confirmed that they were those for which its purchase order provided was correct, the judge would have expected some form of authorisation from Future to export them abroad. No such authorisation was produced. In its absence, the judge accepts as correct a submission by Mr Black that everything pointed to Future being certain that it would receive payment in full for goods supplied and thus consented to their export. Viewed against the whole background of Brayfal's dealings with Future, the judge is simply unable to accept the members' view that no inference should be drawn from the lack of information about the exporting of phones.

128. Mr Kibbler's refusal to accept that Brayfal should have carried out due diligence checks on Boston Freight, Universal's freight forwarder, and his failure to carry out any checks on Hawk illustrate clearly that, notwithstanding that Brayfal included them in its own stated due diligence procedure, Mr Kibbler ignored them. In choosing to carry out only those checks he considered necessary to deal with a given situation, he was not carrying out true diligence.

129. Even if goods truly owned by Brayfal were insured under the policy arranged by Hawk, as Mr Kibbler claimed, the judge doubts that they were covered if they remained in Future's ownership. And since no insurance documentation was produced, despite the facts that the Commissioners requested it and that Brayfal was charged for insurance by Hawk, the judge is not satisfied that goods shipped abroad were insured under Hawk's policy. It was yet another matter that warranted further enquiry, but none was ever made.

130. The judge considers there to be two key features of the cancelled deals which have a bearing on whether Mr Kibbler, and hence Brayfal, had knowledge of fraud. They are: 1) the ease with which the deals were cancelled; and 2) the fact that notwithstanding that the deals were cancelled, Brayfal proceeded to make input tax claims based on invoices relating to them. In relation to (1), the ease with which the deals were cancelled calls into question the commerciality of the arrangements. The loss of a sale would normally put a trader in a difficult position in relation to its own supplier, and probably entail some financial consequences. In Brayfal's case no difficulties whatsoever appear to have arisen despite it having been the party to effect cancellation, nor do any such consequences. That, in the judge's view, supports a submission by Mr Black that the deals were pre-arranged and contrived so that it was only necessary to "unravel" them; they were uncommercial. As to (2), since Brayfal would never be called upon to pay the VAT on the invoices as output tax, and Brayfal went so far as to claim the goods as being "in stock", the input tax claims should never have been made. Their stated basis was simply untrue. The fact that the claims were withdrawn some months later does not affect the position. At [63] the tribunal rejected as demonstrably untrue Mr Kibbler's claim that Brayfal "was not in a financial position to take delivery of and pay for some of the stock", believing his real reason for cancelling the deals to be potential losses on future deals in the absence of repayments of input tax by the Commissioners.

131. There is a third telling feature arising out of the cancelled deals, but which has no real relevance to their cancellation. It is the fact that Brayfal carried out minimal due diligence on its customer Infinity, and none whatsoever on its other customer Elandour (save for checking its VAT registration number). That speaks for itself. It confirms the judge in concluding that by 2006 Mr Kibbler viewed due diligence, to the extent suggested by the Commissioners, as nothing more than an unnecessary hindrance to wholesale traders in mobile phones.

132. A number of points relevant to Brayfal's knowledge or means of knowledge that its transactions with Future were connected with VAT fraud arise in relation to the transaction in which Brayfal "by mistake" failed to pay the VAT on the supply by Future under invoices 5662 and 5663 (see [62]). In respect of those supplies Brayfal would appear still to pursue its input tax claim in full notwithstanding that over three years have elapsed since they were made, and the tax has still not been paid. First, the judge notes that Brayfal sold on the goods concerned and was paid in full shortly after

it purchased them, so that it had no justification for withholding moneys properly due to its creditor. Next, Future has failed to pursue a claim against Brayfal for the moneys concerned yet arranged its own input tax claims against the Commissioners to such a degree of perfection as to ensure that it recovered almost the last pound of its output tax (see [76]). Thirdly, that so determined a trader should apparently have taken no action to recover £200,900 properly due to it from Brayfal indicates to the judge that the deal was not commercial, and he infers that Mr Kibbler must have been aware that it was not. The judge doubts that Future ever intended to seek payment of the moneys from Brayfal. The judge's view is reinforced by the fact that in Brayfal's accounts for the year to 31 March 2007 the amount in question was included as an "extraordinary item" (see[62]). As we pointed out in our earlier decision, and this is the fourth point, in the context of normal commercial trading there was nothing "extraordinary" about the underpayment; it was a perfectly ordinary sum due to a creditor. To the judge the facts relating to the transactions in question are yet more compelling evidence that Brayfal was involved in transactions connected with VAT fraud, and that Mr Kibbler, who was unable or unwilling to provide us with any explanation for Brayfal's failure to make payment, must have been aware of that fact.

133. The members appear to prefer the evidence of Mr Kibbler to that of Mrs Clifford. The judge prefers the converse. As we recorded at [84] and [85] of our original decision, Mrs Clifford initially claimed that a tax loss had been related to Future's invoices 4882 to 4890 and was included in an assessment of £59 million. She was cross-examined on that basis. Later she asked to make a statement, and we allowed her to do so. In it she volunteered that her earlier evidence had been wrong: the tax loss in question had been included in a different assessment for £23 million. Had Mrs Clifford not so volunteered, the judge doubts that the error would have been discovered. In his judgment, Mrs Clifford acted honestly when she discovered the error. Her other evidence having been the subject of detailed cross-examination and made no difference to the answers to questions 1 and 2, to which it was directed, so that the judge regards her as an essentially truthful witness.

134. In contrast, in a number of very important respects, Mr Kibbler's evidence was tested and found by the judge to be less than truthful. First, he claimed that in subjecting Brayfal's input tax claim for March 2006 to extended verification the Commissioners caused Brayfal to close down its business. The whole tribunal found that claim to be untrue. Next, Mr Kibbler claimed to carry out checks with the Commissioners' national helpline on Future's VAT registration prior to Brayfal making alternate deals. The Commissioners' records showed that to be untrue; he carried out but two checks on its registration, on 13 December 2005 and 9 February 2006, and both were made outside Brayfal's period of trading with Universal. Notwithstanding that Future's registration remained valid throughout the period with which the tribunal is concerned and any checks Mr Kibbler might have made would have shown that to be so, the fact is that he failed to make the necessary checks. His evidence was untrue and misleading. He then claimed that he cancelled the deals in 05/06 and 06/06 because Brayfal "was not in a financial position to take delivery of

and pay for some of the stock". That claim was made against a background of Brayfal being given credit on all its purchases by Future and having £1.2 million in its bank account [see 63]. The tribunal rejected his evidence in that behalf as untrue, saying that it believed his reasons for cancelling the deals to be the "potential losses on future deals in the absence of repayments of input tax by the Commissioners". Despite having cancelled the deals, Mr Kibbler proceeded to make input tax repayment claims in respect of them. Those claims totalled over £300,000. In his evidence in chief he claimed that it was not until some 6 months later that he cancelled the transactions and withdrew the claims (see [66]). But in cross-examination he admitted that he had cancelled the deals before what the tribunal found to be the time he submitted the two returns in question. In other words, his original evidence as to the time of cancellation of the deals was untrue; he made input tax claims in relation to moneys which Brayfal would never have to pay – claims which should never have been made. If he had been in any doubt as to the position he had immediately to hand advice from a VAT expert in the form of Mr Munro, his co-director and a barrister. Mr Kibbler went on to submit a schedule or schedules with those returns stating that the goods involved in the cancelled deals were "in stock" [see [64]]. That too was untrue. There is then the evidence of Brayfal failing to pay tax of some £200,000 on the two transactions "by mistake" (see [62]). It is hardly the behaviour of an honest and truthful man to find such "mistakes", notify its supplier that it has done so (which is what happened according to Mr Kibbler), and then fail to pay the tax in question.

135. Mr Kibbler's failure to make full enquiries and investigations before entering into contracts with Future and Universal meant that Brayfal did not discover information that would have led Mr Kibbler into making yet further enquiries. The result was that Brayfal became committed without sufficient protection to enter into transactions with Future linked by way of contra-trading to WadeTech and C & B Trading, the defaulting traders. Had Mr Kibbler put appropriate questions to those with whom Brayfal was trading, the judge is satisfied that that he would have had no alternative but to conclude that the uncommercial features of the deals being offered to Brayfal could only be explained by taking into account other transactions Future had entered into, or would be entering into, and that the most probable, indeed almost certain, explanation was that those other transactions were connected in some way with fraud. The Commissioners have adduced the cogent evidence necessary in cases where fraud is alleged and have satisfied the judge that Mr Kibbler, as Brayfal's owner and director, failed to take every measure reasonably open to him to satisfy himself that the transactions Brayfal was effecting did not result in its participation in VAT evasion. He took little or no commercial care with regard to them, and cannot escape the inference that he deliberately closed his eyes to the probability of fraud: he was guilty of Nelsonian blindness.

136. In the judge's judgment, the checks carried out by Mr. Kibbler were casually undertaken, and negative indicators ignored, because in truth the checks were unnecessary. Mr Kibbler knew perfectly well that Future and Universal would not fail in their obligations for the transactions were pre-arranged and contrived. The

judge thus concludes that Brayfal knew that, by its purchases, it was participating in transactions connected with the fraudulent evasion of VAT. In his judgment, the answer to question 3 must be in the positive.

b) *The members' conclusion (as drafted by them)*

137. Because the members are unable to agree with the judge on many matters they have written their own conclusion. Both members are qualified accountants and between them have over 60 years experience in the profession and industry. We have used our experience in arriving at this conclusion.

138. The concept of contra trading is explained in paragraph 3 of the introduction, but the members believe that in this case the clean chain existed before the dirty chain and it was that dirty chain that was created, presumably by Future at a later date. This is based on the evidence of Mrs Clifford [76] who told us that acquisition deals had been completed mainly in the first month of each quarter; and that the balancing broker deals had been undertaken mainly in the second and third months of each quarter. No evidence was adduced to show that Brayfal was aware of this.

139. It was established at the first hearing [17] that Brayfal commenced exporting mobile phones in 1990 and apart from a small period in 2004/2005 was largely involved in the export of mobile phones for the whole of the period 1990 to 2006 when it ceased to trade. During the whole of this time, we were told that the Commissioners only queried the company's claim to repayment on one occasion in 2003. An appeal by Brayfal to these tribunals was allowed, and its claim was met in full. The members believe that the comments of the judge in [108] of this decision are misleading as, having initially been refused, the claim was subsequently repaid in full. As can be seen from [29] the Commissioners did not contend that Brayfal was knowingly a party to any fraudulent activity, nor did they criticise its trading practices or the manner in which it conducted its business.

140. We have relied on the comments of the European Court in Kittel when it said at [51] that "traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud ……must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT". We take particular note of the word "reasonably" as will be seen later in our conclusion.

141. We have taken note of the comments quoted at [13] of this decision and in particular "having made all proportionate enquiries".

142. Lewison J in *Livewire* used the words "having taken all reasonable steps" and "unless he knows or should have known that there was (or was likely to be) a missing trader somewhere in the dirty chain, I do not see how it can be said that he knew or should have known that his transaction was connected with fraud". In [51] of *Mobilx*

Floyd J again referred to "all reasonable precautions" and "in some cases involve ceasing to trade in specified goods in a particular market".

143. The members take particular note of the fact that in January 2004 Brayfal was advised by the Commissioners that certain goods in which it had dealt may have emanated from an illegitimate source (see [30]) and it therefore stopped trading with that company. An indication to the members that Mr Kibbler wished to deal with reputable companies only.

144. In the *Netto Supermarket GmbH* decision the Court again referred to "every step which could reasonably required". The European Court in *Teleos* used the words "every reasonable measure". Lewison J in *Livewire* used the words "he must have taken every reasonable measure".

145. At [22] of this decision all members of this tribunal found that the Commissioners agreed that Brayfal was not a dishonest co-conspirator. The members knowing Brayfal to be innocent of conspiracy believe it only had to show that the actions it took were reasonable for it to be successful with this appeal. It cannot be said that it knew of a connection between its own transactions and at least one of the frauds (Livewire).

146. Millett J in *Agip (Africa) Ltd*. said "A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party, takes the risk that they are part of a fraud practised on that party". As Brayfal has been found not to be a dishonest co-conspirator this reference can not apply to it.

147. In *Blue Sphere* the Chancellor said at [46] "Plainly not all persons involved in either chain, although connected, should be liable for any tax loss. The control mechanism lies in the need for either direct participation in the fraud or sufficient knowledge of it". In the opinion of the members not only did Brayfal not have "sufficient knowledge", it had no knowledge at all.

148. The members are greatly encouraged by the Chancellor's remarks at [52] in *Blue Sphere* because in their opinion no evidence was adduced by the Commissioners to show that "Brayfal ought to have known that by its purchases it was participating in transactions connected with fraudulent evasion of VAT".

149. Section 77A(2) Value Added Tax Act 1994 uses the words "knew or had reasonable grounds to suspect" again supporting the various court decisions which have invariably used the word "reasonable" in the actions to be taken by the taxpayer. Floyd J, referring to Notice 726, stresses, "the obligation on the trader is to ensure the integrity of his "supply chain"". It must be remembered that Brayfal was in a clean chain where each member correctly dealt with its VAT. Even though the Commissioners said that on certain occasions the VAT paid by Future was in single

figures although it had a multi-million pounds turnover no evidence was adduced to show that this was incorrect and no action was taken by the Commissioners at that time against Future. In fact the Commissioners agreed that when this case first came before the tribunal Future was still actively trading. The members note that none of the examples given in Notice 726 are mandatory and Floyd J in *Mobilx* said, "the company has to exercise independent judgment" which, in the opinion of the members, Brayfal did.

150. In considering Questions 1 and 2 the members are concerned with two matters. Firstly Future was not present at the hearing and therefore unable to comment on the allegations made by the Commissioners and, secondly, Mrs Clifford, the officer responsible for Future's VAT affairs made, in our opinion serious mistakes which cast doubts on her competence. As can be seen at [88] and [89], she told the tribunal Wade Tech was a "hijacked VAT number" whereas it was really a change of name. More serious, in our opinion, was the fact that she misled the tribunal for two full days, producing documents to show that the losses were in an assessment made on 23 November 2007 totalling in excess of £59 million whereas on the third day she said that was incorrect and the losses were in fact in an assessment for £23 million made on 10 November 2006. She was not allowed to produce evidence of this assessment (see [85]). This in our opinion was either done deliberately, which we very much doubt, or reflected her incompetence in dealing with such serious matters. The entire tribunal found the "initial error was grave" (see [43]).

151. Whilst being told by both Mrs Clifford and Mr Simon Devine (Brayfal's assurance officer) that the transactions were part of "an overall scheme to defraud the revenue", no-one could describe the scheme, tell us who arranged it, who was in it, and above all who benefited from it. No evidence was adduced that Brayfal was even aware of it nor was any adduced to show that it, or Future for that matter, derived any benefit from it. In the opinion of the members, the scales are only just tipped in favour of there being a scheme on the balance of probabilities.

152. Question 3 is, in our view, the one the Commissioners have to prove. They have already accepted that Brayfal was not a dishonest co-conspirator (see [22]) so must show that it had "the means of knowledge at the time of entering into its transactions that they were connected to the fraudulent tax losses".

153. The tribunal has already agreed (see [42] of this decision) that no information whatsoever was provided as to why Future was allowed to continue trading despite the Commissioners now stating that it was the "ringleader" (our term) in the scheme, nor was any evidence adduced to show that Future's VAT returns for 01/06, 04/06 and 07/06 were queried despite now being told of the small amounts of VAT payable on exceedingly high turnover. As Future was the only supplier to Brayfal in the relevant periods it seems to us that "at the time of the transactions" the Commissioners themselves were not even sure that anything was amiss with Future; certainly nothing was made public so that companies dealing with them could be

made aware. If the Commissioners were not aware at that time it seems to us that Brayfal was also most unlikely to be aware.

154. Although our attention was drawn to the fact that in the periods concerned only Future and Universal were concerned we would point out that it was found as a fact (see [55]) that Brayfal "purchased phones on a speculative basis i.e. for which it had no purchase order. In our opinion that was not the sign of a company involved in "a scheme to defraud".

155. Although we found (see [48]) that the extended verification of the repayment claims did not affect Brayfal's ability to continue trading in June 2006, the members point out that as the extended verification was being undertaken and the possibility of future repayments being withheld, it would have been extremely foolish for Brayfal to do so. In their opinion it was a sensible commercial decision.

156. The members accepted Mr Kibbler's statement as a fact that IMEI numbers were not unique to individual phones (see [52]). They also take the view that Brayfal's failure to record IMEI numbers would only be of high significance if some evidence that they were stolen, recirculated or did not exist had been made available. No such evidence was provided.

157. At [54] the tribunal recorded that Mr Kibbler "demanded" (the tribunal's word in the original decision) "that Brayfal's input tax claims be processed without extended verification …". The members feel that his apparently aggressive "demand" was born out of frustration with the Commissioners because of their failure to live up to the promises made by them regarding regular meetings with legitimate mobile phone traders and to provide them with support. He was also told by the head of the Commissioners' UK tax fraud policy unit that the MOU "was not worth the paper it was written on".

158. The members fully support Mr Kibbler's view (see [55]) that he could only check Brayfal's own suppliers and customers. They note that he must have asked Future about its supply chain, as he believed that all of the phones he purchased from them were supplied to Future direct from official manufacturers in Europe. Further, they believe that in the "real world" no supplier would disclose the actual source of its supplies to a customer, nor would a reasonable customer expect him to do so. It would be commercial suicide. They also think it unlikely that Hawk would know the source of supply beyond Future. Neither would they expect a retailer purchasing cigarettes from a Cash and Carry to ascertain the source of its supply even if it may have been "bootlegged".

159. Brayfal had been in the export business in mobile phones for many years and the only problem (to use the judge's word) was in 2003. As we have reported earlier that was settled satisfactorily in Brayfal's favour. It is nothing to do with the Commissioners where companies carry out their business. No evidence was adduced

either to show that Brayfal had "traded successfully in the market in which it was then operating", nor was any evidence adduced to show the split of turnover between UK and overseas sales.

160. The members now comment on the section headed "Future" The members think that it is only right to point out at this stage that this is the main area of difference between them and the judge. He basically does not accept what Mr Kibbler said, yet finds as a fact what Mrs Clifford said. The members, coming from a business background, are prepared to accept most of Mr Kibbler's remarks yet cast doubts on those of Mrs Clifford because of the incompetence shown by her whilst giving evidence.

161. The detailed information listed in [64] of this decision was not available to the public at large and is not shown in abbreviated accounts. In any event the relevant accounts would not have been prepared when Brayfal was making enquiries. Details of the figures on Future's VAT returns are confidential to the Commissioners and disclosable at their peril. The members believe that in the "real world" no company would be prepared to disclose confidential financial information to its customers.

162. The members agree with Mr Kibbler that it is unlikely that a bad trade reference would ever be given. They also note that in Blue Sphere a trade reference was supplied by Future Communications.

163. The tribunal did accept (see [66]) that had Brayfal made checks on Future's VAT registration before each deal, it would have been confirmed as correct.

164. The Commissioners observed, "that it made no sense for Hawk to deal with an insurer based in Dubai rather than the UK." We believe that individuals are entitled to take out insurance policies in any country they wish and so take no account of this remark.

165. In the opinion of the members Mr Kibbler would have known whether one or more vehicles would be required based on the size of the order (see [70]).

166. The members do not accept the wording or comments in [77] of this decision concerning Universal. It had been accepted by all members of the Tribunal (see [43]) in the original decision that "when he arrived the area was very busy, and the photographs were taken over the lunch break when things were quiet." As for "renting a portion of the building he visited "as and when he needed it"" the members regard this as normal sensible business practice.

167. Mr Kibbler's contractual arrangements with Future remain unclear with his stated understanding of the contract being at variance with the terms and conditions shown on Future's invoices. The contracts appear to have been fulfilled according the

Mr Kibbler's understanding, with no query from either party, and therefore the members are not prepared to draw any inference on this point.

168. Mr Kibbler stated that he was told, by Future, that they were sourcing goods from official manufacturers and that all of their stock was paid for from its own funds. The members believe that Mr Kibbler would have no means of confirming that this statement was true.

169. As regards FCIB, the members observe that at the relevant time it was a bank properly constituted and authorised by the Netherlands authorities and it was no concern of Brayfal that Universal and FCIB were based in different countries: Universal might use any bank it chose particularly as its customer and the authorisation of the bank came from fellow Europeans.

170. Mr Kibbler bought and sold the mobile phones, on which the repayment of VAT has been withheld, in sterling. The members find nothing unusual in this. A trader who buys and sells in the same currency avoids the possibility of losses due to currency fluctuations and it is sensible to do this, where possible.

171. The members find no problem with Universal having a Graydon credit rating of 8. They would expect any company dealing largely on cash terms to have an unclassified credit rating.

172. In the opinion of the members, no evidence was adduced concerning checks Brayfal made on Hawk. They interpret "Checks are undertaken with freight forwarding agents in each case" as relating to its own agents. They also note checks are made "with" and not "on". The members fully support Mr Kibbler's attitude regarding Boston Freight as they were not his agents and he had no contract with them. The fact that goods were sent to Belgium rather than direct to Austria, because of cost savings, is regarded by the members as normal business practice. No evidence was adduced that Universal was trading in Belgium.

173. The fact that the transactions were customer driven comes as no surprise to the members. In the "real world", purchasers contact different suppliers to see where they can get the best deal. They ascertain whether the goods are available, at what price, delivery dates etc. and then place an order. The tribunal heard no evidence to show that Universal had not carried out this type of enquiry. Also, the tribunal would expect a comparatively new company like Universal, to contact a well-established reputable firm like Brayfal to see if it was able to supply the goods it required.

174. The members do not agree with the judge on some of his remarks in his conclusion and set them out below.

175. They specifically would want to know how (see [111] of this decision) Hawk would have known whether the goods had been imported and how long they had been

in the UK. As mentioned earlier in the "real world" one is not able to check beyond one's own supplier. The remarks in [107] of this decision are purely supposition on the part of the judge. No evidence was heard on this point. Having heard Mrs Clifford it is apparent that Mr Kibbler did have considerably more knowledge of the mobile phone industry than the Commissioners.

176. The members have already commented on the judge's comments at [108] of this decision. It is misleading to say that it had a repayment claim refused as this was later repaid in full and the company was merely returning to exporting which had been the main source of its business throughout the whole life of the company.

177. The closure of accounts with the high street banks was only a temporary disadvantage to Brayfal as they very quickly found alternative facilities in the UK. Brayfal would have been well aware that legitimate traders were having difficulty in obtaining banking facilities from UK banks.

178. Many of the judge's points in [119] of this decision have already been dealt with, but the members will add that in their opinion the only equipment required to trade in mobile phones is a mobile phone and a fax machine, both of which Universal possessed. The members contend that the equipment required to purchase goods worth millions of pounds is no different to that required for a few dozen mobile phones. They also believe that it is not unreasonable for a trader in mobile phones to use a mobile phone rather than a landline.

179. The term "Paying cash" seems to have been misunderstood. Payments were made to Brayfal through its bank account but before delivery of the goods. It was a situation that guaranteed Brayfal funds before it had to pay for its purchases. Universal did not run round with a bag of money but neither did it seek credit terms.

180. As regards the contents of the "Nokia" boxes no evidence was adduced to show that they did not contain what was indicated on the outside of the boxes. In any event Mr Kibbler had no right to examine the boxes or to enquire of Mr Davis as to their contents. This just does not happen in the real world.

181. Turning to [120] of this decision, there is no way that Brayfal could have been aware of "the exponential increase" in Future's turnover. Neither was it able to check on Future's supply chains. The comment about Future not carrying out due diligence on Brayfal is not backed by any evidence. Future was not before the tribunal and no one gave evidence on its behalf. The members pose the question "How would Brayfal know what investigations were carried out by Future into Brayfal's affairs?" (see [74] of this decision) They have already commented on Futures supply source. They believe Mr Kibbler did enquire, was given false information but had no means of checking it.

182. The members do not accept the comment in [123] of this decision, as any wholesale distributor would be expected to hold stock or able to access it at short notice.

183. No evidence was adduced to show that Brayfal did not contact other traders before placing an order with Future. Likewise, no evidence was adduced regarding "such attractive offers of credit". Future was not before the tribunal to give evidence and the seeking of "additional financial information" is not something that goes on in the real world. Companies do not reveal confidential information to other companies.

184. As was mentioned earlier, companies do not carry out enquiries on agents of their customers; it has nothing to do with them who the customer uses as their freight forwarder.

185. As regards the comments on terms and conditions (see [109] of this decision), no evidence was adduced that Brayfal ever had such written terms, although it had been trading for many years in the exporting of mobile phones and had never been found to have carried out any illegal transactions. The Commissioners alleged it had in 2003 but the company was subsequently exonerated. Similarly no evidence was heard to support the Judges view in [126] of this decision.

186. The fact that no goods were returned on the transactions in the periods under appeal in the opinion of the members proves nothing. Nothing was heard about transactions in other periods other than Mr Kibbler telling us that the checks made by Hawk on the goods were adequate, a point which we all accepted.

187. Again, on the question of the cancelled deals no evidence was heard from any other party to the deals so it is not possible to say what effect these had on Brayfal's customer. As for the deals being "pre-arranged", the members point out that many deals are pre-arranged, in that traders often have a customer before seeking a source of supply.

188. The members believe that [91] of this decision, inserted by the judge, is misleading. Although it is correct to say that "Mr Munro gave no evidence" it is fair to point out that this point was not raised by either counsel for the appellant or counsel for the Commissioners. Similarly, it is true to say that Mr Kibbler was not asked to produce a report on his visit to Elandour.

189. Summing up, in the members' opinion Mr Kibbler is an experienced businessman with many years experience of exporting mobile phones. He visited Future on a number of occasions and found what appeared to be a perfectly respectable business with premises appropriate to the level of business he conducted with them. He was aware that some of the staff had experience in trading mobile phones and also that Future had taken over a company, Unique Distribution, which was formerly part of the British Leyland Group, which he knew from his experience

was a reputable company. He asked questions on where they sourced their supplies and was given acceptable answers although not names of actual suppliers. The members believe that no supplier would be prepared to disclose the actual source of its supplies and no reasonable customer would expect him to. For this reason the members conclude that Brayfal did all it could reasonably be expected to do to ensure the integrity of its supply chain.

190. As mentioned earlier the members find no problem with the fact that Future always held in stock or was almost immediately able to obtain precisely the number, type and models of the phones required. They would expect any main supplier to either keep or be able to access stock at short notice. They accept that Future told Mr Kibbler that it owned all of its stock and believe that he would have no means of confirming this.

191. As Lewison J said in *Livewire*: -

> "The honest trader knows that he has bought goods on which he has paid VAT. He knows that he will export these goods and reclaim the VAT from HMRC. Unless there is a missing trader somewhere further down the chain (or in a parallel chain) there is no fraud. I accept that the honest trader need not know the identity of the missing trader but unless he knows or should have known that there was (or was likely to be) a missing trader somewhere in the dirty chain, I do not see how it can be said that he knew or should have known that his transaction was connected with fraud."

192. Mr Kibbler checked that Future's VAT number was valid on 13 December 2005 and on 9 February 2006, although he did not use the method preferred by the Commissioners. The members believe that even at the commencement of the original hearing a check on Future's VAT number, using the preferred method, would have shown it to be perfectly valid. He used the services of Mr Munro, a barrister and former solicitor, to advise him, who concluded that there was no reason why Brayfal should not trade with Future. Here the members note that Mr Munro gave advice, which was not always correct, particularly in respect of the amount of fraud taking place in the industry at the relevant time (see [59]). Brayfal did however employ a professional person to advise on its due diligence, which the members believe was a reasonable thing to do.

193. Mr Kibbler told the tribunal that he obtained an oral trade reference from Hawk on Future and the members have no reason to doubt him.

194. Mr Kibbler arranged for the goods he purchased from Future to be checked, on a sample basis, by Hawk and the members believe that this process was correctly carried out.

195. Brayfal sold to Universal an Austrian company. He did not visit them before conducting the first transaction, due to illness, but did so shortly afterwards. The members find nothing sinister in this; Brayfal is basically a one-man company and illness would naturally prevent him from travelling. What he found was premises suitable for conducting the transactions proposed. The photographs produced were taken over a lunch break, and the members are not surprised that they show lack of activity. They did however show the inside of a warehouse containing cartons marked Nokia and a closed loading bay, which the members are certain would be kept locked at all times other than when loading or unloading was actually taking place. The members do not consider that it would have been reasonable for Mr Kibbler to request the cartons to be opened so that he could inspect the contents. In any event the tribunal heard no evidence as to what they did contain and must assume that they contained Nokia phones as indicated on the boxes. As mentioned earlier, the members see nothing sinister in Universal renting warehouse space as and when needed. This is good normal business practice. Brayfal obtained a copy of Universal's VAT certificate, which it found to be in order. It also obtained a credit report, which gave the risk as unclassified; again not surprising for a fairly new company trading largely on cash terms. Brayfal delivered the goods to Universal's freight forwarder, Boston Freight, in Belgium. The tribunal was informed that this was done to save on freight costs and believe it to be normal commercial practice. The members see no reason why Brayfal should have conducted any due diligence on Boston Freight who was the freight forwarder of its customer.

196. As regards the three cancelled deals the members conclude that Mr Kibbler would have been extremely foolish to go ahead with these deals given that previous deals were being subject to extended verification.

197. The members do not find it unusual that Brayfal failed to make the correct payment to Future for invoices numbered 5662 and 5663, the shortfall being the amount of VAT on both invoices. In the members own experience this does occasionally happen. What they do find unusual is that the error was not corrected immediately upon discovery. They can find no satisfactory explanation for this and assume that Mr Kibbler was in some way attempting to recover some of the losses he might incur through the withholding of his input tax repayment.

198. In coming to their conclusion the members have carefully considered three aspects of the factual evidence which was presented to us in respect of the steps taken by Brayfal to prevent its transactions being tainted by fraud:

a. What steps has the trader actually taken?
b. What steps has the trader not taken which, had he taken them, would have resulted in his being aware that the transactions were tainted by fraud?
c. What steps has the trader not taken, on which we have no evidence, that if he had done so, he would have become aware that the transactions were tainted by fraud?

The members believe that (a) and (b) above must carry a higher weighting than (c).

199. For the above reasons the members have concluded that Brayfal carried out all the reasonable enquiries that were required to prove to their satisfaction that on the balance of probabilities it had no actual knowledge or means of knowledge that the transactions it was entering into were connected with fraud. In coming to this decision they have taken account of the fact that Brayfal did not always conduct the full list of due diligence as suggested in its working practices. They have however concluded that, if it had completed these checks, they have no evidence to show that they would have made Brayfal aware that its transactions were tainted by fraud.

OUTCOME OF THE APPEAL

200. It follows that we confirm that the appeal is allowed to the same extent as in our earlier decision.

201. Either party has a right to apply for permission to appeal against this decision pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. 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.

MAN/2007/0490

DAVID DEMACK
JUDGE

Release Date: 3 March 2010