[2015] UKFTT 0510 (TC)

TC04668

Appeal number: TC/2010/06495

PENALTY PURSUANT TO SECTION 61 VATA 1994 – recusal - test to apply in relation to penalty – right to silence - Article 6 and 7 rights under ECHR – Articles 49 and 50 of the EU Charter – dishonesty – relevance of Kittel – proportionality

FIRST-TIER TRIBUNAL
TAX CHAMBER

UMAAD BUTT **Appellant**

- and -

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

TRIBUNAL: JUDGE JENNIFER BLEWITT
MR JOHN WILSON

Sitting in public at Manchester on 16, 17, 18, 19, 20, 23 and 25 June 2014 with closing submissions on 11 September 2014

Mr Jeremy Benson QC leading Ms Karen Robinson of counsel instructed by the General Counsel and Solicitor of HM Revenue & Customs for the Respondents

Mr Rory Mullan leading Ms Harriet Brown of counsel for the Appellant

© CROWN COPYRIGHT 2015

DECISION

Introduction

1. This is an appeal against HMRC's decision ("the disputed decision") dated 29 March 2010 and confirmed following review on 12 July 2010 by which a penalty was imposed on the Appellant in the sum of £3,137,483.03 pursuant to section 61 of the Value Added Tax Act ("VATA") 1994.

2. The disputed decision was imposed by reference to the Appellant's conduct as a director of Waterfire Ltd ("Waterfire"). The case for HMRC as summarised in its Statement of Case is as follows:

(i) Waterfire rendered itself liable to a penalty pursuant to section 60(1) VATA 1994 in that, for the purpose of evading VAT, it entered into various transactions and rendered VAT returns. In particular, Waterfire made claims to input tax credit when it knew that its underlying transactions were connected with fraud. HMRC allege that Waterfire, through Mr Butt as a director, deliberately and artificially constructed its trading in such a way as to enable what would otherwise give rise to large claims for repayment from HMRC to be offset and made by other companies acting as brokers. It is contended that Waterfire knowingly acted as a contra trader in VAT periods 04/06 and 07/06 as part of a scheme to defraud the public revenue;

(ii) Waterfire sought to evade VAT in the sum of £6,972,184 in VAT period 04/06;

(iii) The conduct giving rise to Waterfire's liability to a penalty was, in whole or in part, attributable to the dishonesty of the Appellant who was at the material time a director and 50% shareholder of the company.

3. By Notice of Appeal dated 11 August 2010 the Appellant appealed against the disputed decision. The grounds of appeal can be summarised as follows:

- The Appellant had significant experience of trading in consumer electronics and in the mobile phone industry;

- Waterfire's transactions were genuine commercial transactions and detailed trading due diligence procedures were carried out to verify this;

- Neither Waterfire nor its directors (Mr Umaad Butt and Mr Tahir Tahir) were aware of any information at the time of the transactions which indicated that the transactions were contrived;

- The Appellant's conduct as a director was not dishonest;

- Waterfire conducted intense due diligence procedures on both suppliers and customers and had been assured by HMRC that it was doing all it could.

Preliminary Matters

4. This seems an appropriate point at which to address the preliminary matters that were raised by the Appellant at the start of the hearing.

5. By email dated Friday 13 June 2014 the Appellant put the Tribunal on notice that an application would be made on the first day of the hearing (Monday 16 June 2014) that Judge Blewitt recuse herself from hearing the substantive appeal. The application arose from her previous involvement in two applications which were heard on 14 May 2014; the first to vacate the substantive hearing and the second to bar HMRC from taking further part in proceedings and summarily determine the appeal in favour of Mr Butt.

6. The relevant decisions which form the background to the application to recuse were as follows:

(a) Summary judgment decision issued on 20 May 2014 refusing the Appellant's application (Appendix A);

(b) Decision refusing permission to appeal issued on 28 May 2014 in respect of (i) the decision not to vacate the substantive hearing and (ii) the summary judgment decision (Appendix B);

(c) Refusal of permission to appeal dated 2 June 2014 in respect of (i) the decision not to vacate the substantive hearing and (ii) the summary judgment decision following consideration on the papers by Judge Berner (Appendix C);

(d) Refusal of permission to appeal dated 10 June 2014 in respect of (i) the decision not to vacate the substantive hearing and (ii) the summary judgment decision following an oral hearing before Judge Sinfield (Appendix D); and

(e) Disclosure directions dated 23 May 2014, 6 June 2014 and 11 June 2014 (Appendix E).

7. The application to recuse was heard by Judge Blewitt alone on 16 June 2014 prior to the commencement of the hearing. Given the potential consequences to the hearing should the application have been granted, a full written decision was issued on 17 June 2014, a copy of which is found at Annex F of this decision. Time was extended for any application for permission to appeal that decision to be made in line with this decision on the substantive matter.

8. Having refused the application Judge Blewitt and Mr Wilson proceeded to hear the substantive appeal. As will become apparent, the Appellant sought to rely on a number of the grounds raised in support of its application for summary judgment against HMRC. It should be made clear that the arguments were heard and considered afresh by this Tribunal and considered in the context of the evidence that was presented (which had not formed part of the application for summary judgment, which was determined on legal submissions only).

Legislation

9. Section 60 VATA 1994 provides as follows:

(1) In any case where-

(a) for the purpose of evading VAT, a person does any act or omits to take any action, and

(b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability),

he shall be liable, subject to subsection (6) below, to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by his conduct.

(2) The reference in subsection (1)(a) above to evading VAT includes a reference to obtaining any of the following sums-

(a) a refund under any regulations made by virtue of section 13(5);

(b) a VAT credit;

(c) a refund under section 35, 36 or 40 of this Act or section 22 of the 1983 Act; and

(d) a repayment under section 39,

in circumstances where the person concerned is not entitled to that sum.

(3) The reference in subsection (1) above to the amount of the VAT evaded or sought to be evaded by a person's conduct shall be construed-

(a) in relation to VAT itself or a VAT credit as a reference to the aggregate of the amount (if any) falsely claimed by way of credit for input tax and the amount (if any) by which output tax was falsely understated; and

(b) in relation to the sums referred to in subsection (2)(a), (c) and (e) above, as a reference to the amount falsely claimed by way of refund or repayment.

(4) Statements made or documents produced by or on behalf of a person shall not be inadmissible in any such proceedings as are mentioned in subsection (5) below by reason only that it has been drawn to his attention-

(a) that, in relation to VAT, the Commissioners may assess an amount due by way of a civil penalty instead of instituting criminal proceedings and, though no undertaking can be given as to whether the Commissioners will make such an assessment in the case of any person, it is their practice to be influenced by the fact that a person has made a full confession of any dishonest conduct to which he has been a party and has given full facilities for investigation, and

(b) that the Commissioners or, on appeal, a tribunal have power under section 70 to reduce a penalty under this section,

and that he was or may have been induced thereby to make the statements or produce the documents.

(5) The proceedings mentioned in subsection (4) above are-

(a) any criminal proceedings against the person concerned in respect of any offence in connection with or in relation to VAT, and

(b) any proceedings against him for the recovery of any sum due from him in connection with or in relation to VAT.

(6) Where, by reason of conduct falling within subsection (1) above, a person is convicted of an offence (whether under this Act or otherwise), that conduct shall not also give rise to liability to a penalty under this section.

(7) On an appeal against an assessment to a penalty under this section, the burden of proof as to the matters specified in subsection (1)(a) and (b) above shall lie upon the Commissioners.

10. Section 61 VATA 1994 provides as follows:

(1) Where it appears to the Commissioners-

(a) that a body corporate is liable to a penalty under section 60, and

(b) that the conduct giving rise to that penalty is, in whole or in part, attributable to the dishonesty of a person who is, or at the material time was, a director or managing officer of the body corporate (a "named officer"),

the Commissioners may serve a notice under this section on the body corporate and on the named officer.

(2) A notice under this section shall state-

(a) the amount of the penalty referred to in subsection (1)(a) above ("the basic penalty"), and

(b) that the Commissioners propose, in accordance with this section, to recover from the named officer such portion (which may be the whole) of the basic penalty as is specified in the notice.

(3) Where a notice is served under this section, the portion of the basic penalty specified in the notice shall be recoverable from the named officer as if he were personally liable under section 60 to a penalty which corresponds to that portion; and the amount of that penalty may be assessed and notified to him accordingly under section 76.

(4) Where a notice is served under this section-

(a) the amount which, under section 76, may be assessed as the amount due by way of penalty from the body corporate shall be only so much (if any) of the basic penalty as is not assessed on and notified to a named officer by virtue of subsection (3) above; and

(b) the body corporate shall be treated as discharged from liability for so much of the basic penalty as is so assessed and notified.

(5) No appeal shall lie against a notice under this section as such but—

(a) where a body corporate is assessed as mentioned in subsection (4)(a) above, the body corporate may appeal against the Commissioners' decision as to its liability to a penalty and against the amount of the basic penalty as if it were specified in the assessment; and

(b) where an assessment is made on a named officer by virtue of subsection (3) above, the named officer may appeal against the Commissioners' decision that the conduct of the body corporate referred to in subsection (1)(b) above is, in whole or part,

attributable to his dishonesty and against their decision as to the portion of the of the penalty which the Commissioners propose to recover from him.

(6) In this section a "managing officer", in relation to a body corporate, means any manager, secretary or other similar officer of the body corporate or any person purporting to act in any such capacity or as a director; and where the affairs of a body corporate are managed by its members, this section shall apply in relation to the conduct of a member in connection with his functions of management as if he were a director of the body corporate.

Burden and standard of proof

11. It was the subject of agreement between the parties that the burden of proof in this appeal rested with HMRC. As we understood it, the Appellant (as indicated by the submission quoted below) appeared to suggest that although the civil standard of the balance of probabilities applies a heightened standard is required as the appeal involves an allegation of dishonesty. We did not accept that any heightened standard applies in this case and we cannot add anything useful to the words of Lord Hoffman in *Re B* [2009] 1 AC 11:

"I think the time has come to say once and for all that there is only one civil standard of proof and that that is proof that the fact in issue more probably occurred than not."

Authorities

12. We were referred to a large number of authorities, all of which we considered carefully. It may be useful to set out extracts from some of those authorities at this stage to demonstrate the various principles the parties submitted were relevant to our determination of the issues in this appeal.

13. The case of *Red 12 Trading Ltd v The Commissioners for HM Revenue and Customs* [2009] EWHC 2563 (Ch) at [2] – [7] provided the following explanation of MTIC fraud:

"This case concerns what is called "Missing Trader Intracommunity Fraud" ("MTIC fraud"). Anyone reading this judgment is likely to be familiar with this expression, which has been explained in several tribunal and High Court decisions. The classic way in which the fraud works is as follows. Trader A imports goods, commonly computer chips and mobile telephones, into the United Kingdom from the European Union ("EU"). Such an importation does not require the importer to pay any VAT on the goods. A then sells the goods to B, charging VAT on the transaction. B pays the VAT to A, for which A is bound to account to HMRC. There are then a series of sales from B to C to D to E (or more). These sales are accounted for in the ordinary way. Thus C will pay B an amount which includes VAT. B will account to HMRC for the VAT it has received from C, but will claim to deduct (as an input tax) the output tax that A has charged to B. The same will happen, mutatis mutandis, as between C and D. The company at the end of the chain – E – will then export the goods to a purchaser in the EU. Exports are zero-rated for tax purposes, so Trader E will receive no VAT. He will have paid input tax but because the goods have been exported he is entitled to claim it back from HMRC. The chains in question may be quite long. The deals giving rise to them may be effected within a single day. Often none of the traders themselves take delivery of the goods which are held by freight forwarders.

The way that the fraud works is that A, the importer, goes missing. It does not account to HMRC for the tax paid to it by B. When HMRC tries to obtain the tax from A it can neither find A nor any of A's documents. In an alternative version of the fraud (which can take several forms) the fraudster uses the VAT registration details of a genuine and innocent trader, who never sees the tax on the sale to B, with which the fraudster makes off. The effect of A not accounting for the tax to HMRC means that HMRC does not receive the tax that it should. The effect of the exportation at the end of the chain is that HMRC pays out a sum, which represents the total sum of the VAT payable down the chain, without having received the major part of the overall VAT due, namely the amount due on the first intra-UK transaction between A and B. This amount is a profit to the fraudsters and a loss to the Revenue.

...A jargon has developed to describe the participants in the fraud. The importer is known as "the defaulter". The intermediate traders between the defaulter and the exporter are known as "buffers" because they serve to hide the link between the importer and the exporter, and are often numbered "buffer 1, buffer 2" etc. The company which export the goods is known as the "broker".

The manner in which the proceeds of the fraud are shared (if they are) is known only by those who are parties to it. It may be that A takes all the profit or shares it with one or more of those in the chain, typically the broker. Alternatively the others in the chain may only earn a modest profit from a mark up on the intervening transactions. The fact that there are a series of sales in a chain does not necessarily mean that everyone in the chain is party to the fraud. Some of the members of the chain may be innocent traders.
There are variants of the plain vanilla version of the fraud. In one version ("carousel fraud") the goods that have been exported by the broker are subsequently re-imported, either by the original importer, or a different one, and continue down the same or another chain. Another variant is called "contra trading", the details of which are explained in paragraphs 9 and 10 of the judgment of Burton J in R (on the application of Just Fabulous (UK) Ltd) v HMRC [2008] STC 2123. Goods are sold in a chain ("the dirty chain") through one or more buffer companies to (in the end) the broker ("Broker 1") which exports them, thus generating a claim for repayment. Broker 1 then acquires (actually or purportedly) goods, not necessarily of the same type, but of equivalent value from an EU trader and sells them, usually through one or more buffer companies, to Broker 2 in the UK for a mark up. The effect is that Broker 1 has no claim for repayment of input VAT on the sale to it under the dirty chain, because any such claim is matched by the VAT accountable to HMRC in respect of the sale to UK Broker 2. On the contrary a small sum may be due to HMRC from Broker 1. The suspicions of HMRC are, by this means, hopefully not aroused. Broker 2 then exports the goods and claims back the total VAT. The overall effect is the same as in the classic version of the fraud; but the exercise has the effect that the party claiming the repayment is not Broker 1 but Broker 2, who is, apparently, part of a chain without a missing trader ("the clean chain"). Broker 2 is party to the fraud."

14. The present case involves an allegation that the Appellant acted as a "contra-trader". We should note that throughout this decision the use of terms such as "broker", "defaulter", "buffer", "acquirer", "contra-trader", "clean chain" and "dirty chain" are used for the purposes of convenience and without any inference of pre-judging the issues.

15. In *Blue Sphere Global Ltd and The Commissioners for HM Revenue and Customs* [2009] EWHC 1150 (Ch) the Chancellor stated (at paragraphs 42 – 45):

"…The nature of any particular necessary connection depends on its context, for example electrical, familial, physical or logical. 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 effect.

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 (Infinity) in the dirty chain, which is the counterpart of the obligation of A to account for input tax paid by B, is transferred to E (BSG) in the clean chain. Such a transfer is apt…to conceal the fraud committed by A in the dirty chain in its failure to account for the input tax received from B."

16. The cases of *Kittel v Belgium, Belgium v Recolta Recycling* [2008] STC 1537*("Kittel")* and *Mobilx Ltd (in administration) v HMRC* [2009] STC 1107 made clear that there is no discretion on the part of the Authorities to withhold any tax repayment where the objective criteria for compliance with the VAT regime are met. At paragraph 61 the Court stated:

"*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.*"

17. The test was further clarified by Moses LJ in *Mobilx & Others v The Commissioners for HM Revenue and Customs* [2010] EWCA Civ 517 at paragraph 24:

"The scope of VAT is identified in Art. 2 of the Sixth Directive. It applies, in addition to importation, to the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such. A taxable person is defined in Art. 4.1 as a person who carries out any of the economic activities specified in Art. 4.2. Art. 5 defines the supply of goods and Art. 6 the supply of services. The scope of VAT, the transactions to which it applies and the persons liable to the tax are all defined according to objective criteria of uniform application. The application of those objective criteria are essential to achieve:-

> *"the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional circumstances, to the objective character of the transaction*

concerned." (Kittel para 42, citing BLP Group [1995] ECR1/983 para 24.)

And at paragraph 30:

"...the Court made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met."

Issues

18. The issues identified by HMRC can be summarised as follows:

(a) Did Waterfire do any act for the purpose of evading VAT (or, by virtue of Section 60(2)(b), for the purpose of obtaining a VAT credit in circumstances where it was not entitled to that sum)?

(b) Did the conduct of Waterfire in doing that act for the purpose of evading VAT involve dishonesty?

(c) If so, was Waterfire liable to a penalty in the sum of the VAT evaded or sought to be evaded?

(d) What was the amount (if any) of the VAT evaded or sought to be evaded?

(e) Was the conduct giving rise to the penalty, in whole or in part, attributable to the dishonesty of the Appellant who was at the material time a director of Waterfire?

(f) Ought the quantum of the penalty be reduced?

19. The Appellant served its List of Issues on HMRC and the Tribunal on 21 May 2014 in which the following were said to be "matters accepted":

(a) HMRC's evidence as to the transactions which can be traced to fraudulent defaulters; and

(b) HMRC's evidence as to the participants in the various transaction chains.

20. The following were identified by the Appellant as the issues to be determined:

(a) Has a valid penalty notice been issued;

(b) What was Waterfire's involvement (if any) in the missing trader fraud;

(c) Was there a commercial rationale for Waterfire's trade;

(d) Was Waterfire's reliance on HMRC reasonable;

(e) Did Waterfire evade VAT in making a claim for input tax on supplies made to it;

(f) Was the claim to input tax on supplies made to Waterfire a false claim and, if so, did the directors of Waterfire appreciate it was a false claim;

(g) Was Waterfire dishonest in entering into the trades;

(h) Was Waterfire dishonest in making a claim to input tax;

(i) If Waterfire was liable to a penalty under Section 60 VATA 1994, was its conduct attributable to the dishonesty of the Appellant;

(j) To what extent did Waterfire and/or the Appellant benefit from the trades on which input tax was denied;

(k) Is the penalty proportionate having regard to the extent of that benefit.

Undisputed Background Facts

21. Waterfire was incorporated on 28 April 2004 and registered for VAT with effect from 5 July 2004. Mr Butt was appointed as director on 16 June 2004 and Mr Tahir Tahir was appointed a director on 12 July 2005. Each owned 50% of the issued share capital of the company.

22. According to Companies House the following were appointed as company officers:

- Mr Hasan Desai: director of Waterfire from 12 to 17 January 2009 and company secretary from 12 January to 14 September 2009;
- Mr Yousef Vaqar Anwar: company secretary from 1 July 2009 to 1 September 2009;
- Mr Phil Royle: director with effect from 11 October 2008;
- Mr Michael James Ratu: director with effect from 19 February 2009.

23. Waterfire's intended trade as set out in the VAT1 was the wholesale of fancy goods, the wholesale and retail of electrical equipment and white goods, and consumer electronics. The anticipated turnover in the first twelve months was £900,000. During a pre-registration visit on 12 August 2004 the directors also indicated that they were considering trade in used mobile phone handsets, electricity generators and harvesting machinery to developing markets in Pakistan. In fact Waterfire never traded in the retail or wholesale of fancy goods or white goods nor did any transactions take place involving used mobile phone handsets, electricity generators or harvesting machinery.

24. During the course of their employment by Waterfire neither Mr Butt nor Mr Tahir is recorded as receiving any salary. Each received identical dividends of £18,888.89 in tax year 2004/05 and £88,888.89 in tax year 2005/06. In August 2006 Waterfire paid £125,000 each to Mr Butt and Mr Tahir. Those payments were described as "bonuses". Neither Mr Butt nor Mr Tahir declared this income on their respective 2006/07 self-assessment tax returns.

25. By letter dated 4 July 2007 HMRC notified Waterfire of its decision to deny it the right to deduct input tax in the sum of £6,972,184.53 claimed in respect of 32 transactions conducted in the 04/06 period.

26. By Notice of Appeal dated 11 July 2007 Waterfire appealed against that decision. In a letter dated 31 March 2008 signed by Mr Butt on behalf of Waterfire, the company withdrew its appeal against the decision.

27. The Appellant and Mr Tahir both resigned their directorships on 26 June 2009. Waterfire was the subject of a compulsory winding up order on 25 January 2011.

Evidence

28. We heard evidence from the following witnesses:

- HMRC officer Millroy;
- HMRC officer Lyon;
- HMRC officer Mody;
- HMRC officer Sharkey;
- Mr Fletcher, an independent consultant subcontracted to KPMG LLP;
- HMRC officer Humphries; and
- HMRC officer Stone.

29. Many of the statements produced as evidence-in-chief on behalf of HMRC were voluminous, for instance that of Mr Mody totalled 239 pages. For that reason the evidence set out below is intended as an overview of the main issues in dispute or to provide background as to the nature of the appeal.

Mr Mody

30. Mr Mody's involvement in this appeal arises from his role as allocated officer with responsibility for aspects relating to the trading activities of Waterfire which involved:

- Contact with the principal officers of the company in person, by telephone and in writing;
- Examination and analysis of business records provided by those officers;
- Visits to the company's principal place of business;
- Verification of VAT returns submitted by the company;
- Scheduling and uploading to HMRC systems of transaction data provided by the company; and
- Dissemination of information relating to the company's trading activity to other linked teams within HMRC.

31. The company's VAT returns for periods 10/04, 01/05, 04/05 and 07/05 (the company's first year of trade) contained output figures showing a turnover of

£17,130,164 which significantly exceeded the anticipated turnover of £900,000 declared on the VAT1. A summary of the company's returns throughout its period of registration is as follows:

Period	Inputs (£)	Outputs (£)	Input Tax (£)	Output Tax (£)	Net Tax (£)
First Period	0	0	0	0	0.00
12/04	4,058,434	4,091,175	710,203	716,008	5,804.94
03/05	4,826,900	4,872,395	844,509	851,252	6,742.75
07/05	8,134,044	8,166,594	1,422,455	1,204,167	-218,287.91
10/05	17,128,141	17,342,543	2,997,425	2,624,104	-373,320.87
01/06	48,399,985	48,953,930	8,469,997	7,800,309	-669,688.63
04/06	77,836,669	78,787,295	13,606,873	12,344,248	-1,262,625.13
07/06	22,953,399	23,259,915	4,017,499	4,021,426	3,926.63
10/06	3,902	0	683	0	-683.06
01/07	4,435	0	776	0	-776.10
04/07	4,860	1,395	851	244	-606.37
07/07	1,140	0	0	0	-199.51
10/07	355	0	59	0	-59.10
01/08	2,211	0	321	0	-320.50
04/08	759	0	131	0	-131.32
07/08	661	0	114	0	-114.09
Final Period	0	0	0	0	0.00

32. The main trading period of the company was 7 October 2004 to 28 July 2006. All 8 VAT returns covering this period were signed by Mr Butt. The company's turnover during the trading period can be summarised as follows:

- For the year ending 2005: £17,130,164
- For the year ending 2006: £168,843,683
- For the year ending 2008: £1,395

33. The following table shows extracts from the annual accounts of Waterfire for the years ending April 2005 to April 2008 were:

Year Ending	Date Annual Accounts Signed Off	Signatory to Annual Accounts	Turnover declared on Annual Accounts (£)
30 April 2005	12 July 2005	Jamal Tahir	8,459,871
30 April 2006	13 April 2009	Phil Royle	4,144,069
30 April 2007	15 May 2009	Phil Royle	4,910,722
30 April 2008	23 June 2009	Phil Royle	5,568,759
30 April 2009	30 January 2009	Phil Royle	6,069,947

34. Mr Mody highlighted the inconsistency between the figures declared on the company's VAT returns as compared with those on its annual accounts. For the three years to 30 April 2007 Waterfire declared a turnover of £185,976,637 on its VAT returns yet declared only £17,514,662. In the financial year ended 2006 there is a discrepancy of £149,106,293 between the returns and the accounts. Mr Mody also drew attention to the fact that the annual accounts for the year were signed off by Mr Royle three years after the trading year rather than Mr Butt or Mr Tahir who were the directors during the relevant period. The annual accounts for the financial year ended 2008 were also signed off by Mr Royle despite covering a period in which he had not been a director of the company. Those accounts show a turnover of £5,568,759 whereas the corresponding VAT returns declared no outputs. Mr Royle also signed off the accounts for the financial year ended 2009 during which period he was a director. Those accounts show a turnover of £6,069,947 yet the 07/08 VAT return showed no outputs.

35. Mr Mody set out in his written evidence particular aspects relating to Mr Butt and Mr Tahir. He noted that Waterfire's bank records indicate that Mr Butt and Mr Tahir both received substantial payments in August 2006 yet neither declared the income on an income tax return. The bank statements show that payments of £125,000 were paid to each director marked on the entry description as "bonus". Mr Butt subsequently described these as directors' loans, an explanation which Mr Mody noted was at odds with the directors' comments to him at a visit to the company's premises on 21 June 2006 at which he was advised that there were no outstanding loans to the business at that time.

36. HMRC's Self Assessment statement show that Mr Butt failed to submit his Income Tax Self Assessment returns for the tax years 06/07, 07/08 and 08/09 incurring fixed penalties for each year and an estimated determination of tax for 07/08.

37. As regards previous employment Mr Mody explained that Mr Butt, Mr Tahir and Mr Shariff (one of two staff members at Waterfire) had all worked at a company called Cellstar together where they received identical salaries. Having left Cellstar Mr Butt and Mr Tahir subsequently worked at 20:20 again being paid identical salaries. Thereafter Mr Butt, Mr Tahir and Mr Shariff all worked at Square 1 together where they received identical salaries. Upon leaving Square 1 Mr Butt and Mr Tahir were appointed as directors of Waterfire and Mr Shariff joined the firm later.

38. As to the directors' knowledge of MTIC fraud during the relevant period Mr Mody highlighted that correspondence on behalf of Waterfire from Mr Holmes at Borders in July 2004 stated:

"The trade sector in which Waterfire intend to trade is rife with fraud."

39. Furthermore during a pre-registration visit in August 20-4 Mr Butt and Mr Tahir acknowledged their awareness of MTIC fraud stating that they had been informed of the fraud risks associated with trading in mobile phones and electrical goods whilst employed at Square 1. During that same visit HMRC had also issued to the directors Notices 726 ("Joint and Several Liability in the Supply of Specified Goods"), Notice 700/52 ("Security as a Condition of releasing a VAT Credit") and the Input Tax Statement of Practice with a verbal explanation of each.

40. Mr Mody also noted that Mr Butt and Mr Tahir had been told of the problems associated with the mobile phone trading sector while employed at Square1.

41. HMRC continued to draw the risks and tax losses associated with MTIC fraud to Waterfire's attention throughout its trading period. By way of example Mr Mody noted that discussions on the issue took place at a visit on 21 September 2005. Thereafter the company was notified on a number of occasions when its transactions were traced back to tax losses, for instance by letters dated 21 November 2005, 10 February 2006, 29 June 2006, 7 July 2006 and 21 July 2006. Mr Mody noted that despite HMRC letter of 21 November 2005 in which Waterfire was notified that 6 of its 11 transactions in July 2005 had been traced back to tax losses and that third party payments had been identified, it nevertheless continued to trade with one of the immediate suppliers in those 6 transactions, Gee-Tec Ltd. On 6 December 2005 Mr Tahir told HMRC that the company no longer dealt with companies which had supplied it in tax loss chains. Mr Mody highlighted the inconsistency of this comment with the fact that Waterfire continued to deal directly with Gee-Tec Ltd.

42. Mr Mody set out in detail the transactions undertaken by Waterfire in periods 04/06 and 07/06.

43. Waterfire's VAT return for 04/06 was received by HMRC on 16 May 2006. It showed a net claim for VAT repayment amounting to £1,262,625.13. On 23 May 2006 Mr Mody commenced his verification of the claim. He subsequently concluded that the transactions undertaken during 04/06 formed part of an overall scheme to defraud and that Waterfire's principal officers were aware that this was the case. As a result by letter dated 4 July 2007 HMRC denied Waterfire its right to recover input tax amounting to £6,972,184.53 on its 32 transactions in 04/06. Waterfire's appeal to the VAT and Duties Tribunal was withdrawn on 31 March 2008.

44. During verification of the 04/06 transactions Mr Mody established that Waterfire's trading activity during that period included:

- 47 transactions in which Waterfire purchased goods from a supplier in the EU and sold them to a company in the UK, thereby acting as an "acquiring trader" in the chain of supply;
- 6 transactions in which Waterfire purchased from a supplier in the UK and sold to a supplier in the UK, thereby acting as a "buffer" trader in the supply chain;

- 32 transactions in which Waterfire purchased goods from a supplier in the UK and sold them to a customer in the EU, thereby acting as a "broker trader" in the supply chain.

45. Waterfire's VAT return for the period showed the following:

- Total Net Sales: £79,287,295
- Total Net Purchases: £77,753,554
- Net EU Supplies: £40,968,612
- Net EU Purchases: £32,219,877
- Total Output Tax (including acquisition tax): £12,344,248.07
- Total Input Tax (including acquisition tax): £13,606,873.20
- Net Repayment Claimed: £1,262,625.13

Broker Deals

46. Of the 32 broker deals Mr Mody traced 27 back to a missing, hijacked or otherwise defaulting trader. The total tax loss arising from those 27 transactions is £5,430,747.75. Waterfire had purchased from the following 6 suppliers:

- International Electrical Distributors Ltd;
- Epinx Ltd;
- Gee-Tec Ltd;
- Prime Commodities (UK) Ltd;
- Prime Telecom (UK) Ltd;
- H and O Trading Ltd.

47. The defaulters were:

- A Taxable Person Purporting to be The Export Company (UK) Ltd;
- A Taxable Person Purporting to be R&M Electrical Wholesalers Ltd;
- A Taxable Person Purporting to be Eutex Ltd;
- PM Wholesale Electrical Ltd;
- LTH Ltd;
- Prestige 29 UK Ltd.

<u>Defaulters</u>

48. Although there was no challenge to HMRC's tracing of Waterfire's supply chains to fraudulent tax losses, it may assist to provide a brief summary of the defaulting traders involved.

A Taxable Person Purporting to be Eutex Ltd ("ATPPTB Eutex"):

49. ATPPTB Eutex featured in 12 of the transactions in 04/06. HMRC also concluded that on the balance of probabilities a further transaction which was traced back to Dialhouse Electrics Limited ("Dialhouse") would also have featured ATPPTB Eutex however Dialhouse failed to provide any records to HMRC in respect of the relevant transaction thereby blocking HMRC's attempts to trace the chain of supply beyond it.

50. The relevant tax liability on the transactions involving ATPPTB Eutex has never been remitted to HMRC and consequently the total tax loss arising from these transactions is £2,547,970.21. HMRC established that the VAT registration number contained on ATPPTB Eutex's sales invoices held by its customers is not valid and was not issued by HMRC. The invoices also show a different company logo to the legitimately registered Eutex Ltd. Assessments covering these losses were issued to ATPPTB Eutex on 10 April 2007 and 19 September 2007.

ATPPTB R&M Electrical Wholesalers Limited ("ATPPTB R&M"):

51. ATPPTB R&M featured in 3 of Waterfire's transactions in 04/06. HMRC established that the VAT registration number contained on ATPPTB R&M's sales invoices was not valid and the relevant tax liability on the transactions involving ATPPTB R&M has never been remitted to HMRC. Consequently the total tax loss arising from these transactions is £594,582.71. An assessment covering these losses was issued to ATPPTB R&M on 26 September 2007.

ATPPTB The Export Company (UK) Ltd ("ATPPTB TEC")

52. ATPPTB TEC featured in 6 of Waterfire's transactions in 04/06. The relevant tax liability on the transactions involving ATPPTB TEC has never been remitted to HMRC and consequently the total tax loss arising from these transactions is £1,338,151.42. Assessments were issued to ATPPTB TEC on 3 July 2007 and 3 November 2008.

53. HMRC established that the address quoted on ATPPTB TEC's invoices was not that of the VAT registered company The Export Company (UK) Ltd. The invoices also contained a different logo, telephone and fax number than those of the genuine company. HMRC also found third party payment instructions from ATPPTB TEC's customers meaning that the customers received at most a commission payment for the supply rather than the invoice amount.

Prestige 29 UK Limited ("Prestige")

54. Prestige featured in 2 of Waterfire's transactions in 04/06. The relevant tax liability on the transactions involving Prestige has never been remitted to HMRC and consequently the total tax loss arising from these transactions is £281,255.82 Assessments were issued to Prestige in October 2007.

55. HMRC established that Prestige declared its trading activity on the VAT1 as *"kitchen and bathroom supplies."* It was compulsorily wound up on 27 June 2007. Assessments of tax were issued to Prestige on 16 January 2007, 2 October 2007, 17 January 2008, 22 January 2008 and 6 March 2008 to cover unpaid VAT on transactions which were traced back to the company.

LTH Limited ("LTH")

56. LTH featured in 2 of Waterfire's tax loss deals in 04/06. The relevant tax liability on those transactions has never been remitted to HMRC and consequently the total tax loss arising from these transactions is £516,218.06. An assessment was issued to LTH on 21 January 2007.

57. HMRC established that LTH was registered for VAT between August 2004 and May 2006. It is now insolvent. The VAT1 application declared the company's trading activity as *"retail of children's designer wear."* The VAT returns submitted by the company until December 2005 did not declare the full amount of trading undertaken by the company. The Insolvency Service confirmed to HMRC by letter dated 26 March 2009 that LTH's director Denver John Tilstone had been disqualified from acting as a director for a period of 12 years as a result of matters relating to MTIC fraud.

PM Wholesale Electrical Limited ("PM")

58. PM featured in 1 of Waterfire's tax loss deals in 04/06. The relevant tax liability on that transaction has never been remitted to HMRC and the total tax loss arising from the transaction is £151,351.20. An assessment was issued to PM on 6 November 2007.

59. PM was incorporated in October 2005 and registered for VAT from 1 February to 7 April 2006 operating from a room in a business centre in Manchester. The intended trading activity declared on the VAT1 was "wholesale electrics" with an anticipated turnover in the first year of £250,000. However the sales invoices subsequently produced by PM in relation to approximately 750 transactions showed a turnover in the region of £350,000,000 in the company's first and only two months of trading. The only suppliers used by PM were ATPPTB Eutex and ATPPTB R&M; as neither was registered for VAT the invoices held by PM in support of its purchases were not valid for VAT purposes. In an interview with HMRC the director of PM stated that for each transaction undertaken the company had passed on third party payment instructions to its customer and received, as a result, a total of £60,000 for the £350,000,000 of trade it had carried out. By letter dated 29 May 2009 The Insolvency Service confirmed to HMRC that PM's director, Paul Makin had been disqualified in respect of matters relating to MTIC fraud for a period of 14 years.

Buffer deals

60. As regards the six buffer deals carried out by Waterfire, in each case Waterfire's customer acted as broker and sold to one of three EU customers with whom Waterfire traded directly in period 04/06 and 07/06:

- Kom Team SARL;

- Phones-C@nnected SARL; and
- Hi-Lo Sweden AB.

61. Mr Mody established that in each of the six transactions a missing, hijacked or otherwise defaulting trader featured at the start of the UK supply chains. Each of those traders failed to discharge their output tax liability to HMRC thereby causing tax losses totalling £912,964.46 in respect of which assessments were issued.

62. Mr Mody highlighted common features between these buffer transactions and those in which Waterfire acted as broker:

- In two of the six deals Waterfire was supplied by Gee-Tec Ltd and the identified defaulting trader was ATPPTB Eutex. Gee-Tec also supplied Waterfire in eight of its 32 broker deals in the same period and ATPPTB Eutex featured in 12 of Waterfire's broker deals in 04/06 and 11 of its broker deals in 07/06;

- In one deal Waterfire's supplier was Prime Telecom (UK) Ltd and the identified defaulting traders (in the split deal) were Lakeland Trade Frames Ltd and SAS Fire and Security Ltd. Prime Telecom (UK) Ltd also directly supplied Waterfire in two of its broker deals in the same period and Lakeland featured in one of Waterfire's broker transactions.

63. The total net sales value of Waterfire's six buffer deals in 04/06 was £5,645,550. All six deals involved the purchase and sale of Nokia mobile phones and all took place in March 2006. Mr Mody highlighted the average unit profit made by Waterfire in its buffer transactions of £0.45 as compared with that in its broker sales of Nokia phones in the same period of £5.62.

Acquisition deals

64. Of the 47 deals in which Waterfire purchased directly from an EU supplier and sold to a UK customer Mr Mody established that in all but two the UK customer sold to one of 10 different EU customers:

- 2Trade BVBA (Belgium);
- Coburg Trading SL (Spain):
- Elandour Development SARL (France);
- FAF International SRL (Italy);
- Hennar SA (Germany);
- Kiara Trading International SARL (France);
- Kom Team SARL (France);
- Nano Infinity SARL (France);
- Phones-C@nnected SARL (France);

- Proinserco SL (Spain).

65. The three different types of transaction undertaken by Waterfire affected its VAT liability in different ways:

- The buffer transactions affected the company to a relatively minimal extent, resulting in a tax due liability of £1,322.64;

- The broker transactions resulted in input tax reclaimable of £6,972,184.53; and

- The acquisition transactions resulted in output tax payable of £5,717,798.33.

66. The overall net effect was the submission of a claim for repayment for period 04/06 being submitted by Waterfire amounting to £1,262,625.13. Mr Mody highlighted that if 5 broker deals were isolated as being distinct from the other transactions (which were all traced to direct tax losses) the overall net effect of Waterfire's trading activity excluding those deals was:

- The buffer transactions resulted in a tax due liability of £1,322.64;

- The broker transactions resulted in input tax reclaimable of £5,706,616.90; and

- The acquisition transactions resulted in output tax payable of £5,717,798.33.

67. The net effect would have been a tax liability due of £2,942.50. Mr Mody concluded that by undertaking both acquisition and broker deals in the manner and to the extent that it did, Waterfire's trade was artificially arranged and constructed during period 04/06 as part of a contra trading scheme.

68. Mr Mody also highlighted the lengths of Waterfire's broker and acquisition supply chains, and the number of participants therein, which followed a pattern:

- Of the 47 occasions where Waterfire acted as the acquiring trader, 41 of those deals involved Waterfire's immediate customer acting as the broker trader. There were therefore only 2 UK participants in those supply chains. In the remaining six acquisition deals, five featured three UK participants and one featured four.

- Of the 27 transactions in which Waterfire was the broker trader (excluding the Epinx deals) there were generally six to seven UK participants in the chain.

69. An almost identical pattern occurred in Waterfire's 07/06 deals.

70. The 5 remaining broker transactions were all dated 29 April 2006. Mr Mody distinguished these transactions (the "Epinx transactions"), which were not traced directly, back to a tax loss.

<u>Epinx Ltd ("Epinx")</u>

71. HMRC officer White who was the responsible officer for the company from May 2006 to April 2008 gave unchallenged evidence regarding Epinx.

72. The company was incorporated on 20 December 2004 as Epinx Ltd. It changed its name in October 2006 to Libra Fair Trades Ltd t/a Epinx. The principal director and shareholder was Paula Susan White who was appointed as director on 12 October 2004. Other company officials between 2005 and 2007 were:

- Marion Waldron who was appointed company secretary on 12 October 2004 and resigned on 10 August 2005;

- Elizabeth Ford who was appointed company secretary on 10 August 2005 and director on 20 September 2006. She resigned both appointments on 28 February 2007;

- Helen Icely who was appointed as director on 20 September 2006.

73. Epinx was registered for VAT with effect from 10 April 2005. Its first taxable supply was made on 1 March 2005 and the annual estimated turnover was £700,000. The business activity was described as online resellers of computers, printers, cameras and peripherals. The company failed on 31 January 2008 and the VAT registration was cancelled with effect from 14 April 2008. On 19 August 2009 the Secretary of State for Business, Enterprise and Regulatory Reform accepted from Paula Susan White an undertaking that she would not be a director of a company for a period of 12 years because *"during the period 01 April 2005 to 30 June 2006 she caused Libra Fair Trades Ltd to undertake a method of trading which involved it in, and put HM Revenue and Customs at risk of being subject to, a Missing Trader Intra Community Value Added Tax fraud. If she did not know, then she was reckless or grossly negligent as to whether Libra was concerned in such a fraud."*

74. On 21 July 2005 a repayment claim for £82,243.60 was submitted by Epinx for its first period return (06/05). The outputs declared on this return for the 3 month period exceeded £1,000,000. Enquiries were initiated by HMRC into the return.

75. On 28 October 2005 Epinx submitted its return for VAT period 09/05 which showed a further repayment claim of £1,611.78. The turnover for this period was declared as more than £3,300,000, an increase of 230% on the previous period.

76. On 30 January 2006 Epinx submitted its return for 12/05 that showed a net repayment of £8,448.8, released by HMRC without further enquiry. The turnover in this period exceeded £23,000,000, an increase of 596% on the sales in the previous period.

77. On 28 April 2006 Epinx submitted its return for 03/06 that showed a net payment of £7,670.15. The turnover in this period increased to £77,000,000, an increase of 235%, or approximately £54,000,000 on sales for the previous period. The details of this return were:

Output tax	£7,538,532.57
Acquisition tax	£0.00
Total output tax	£7,538,532.57
Input tax	£7,530,862.43

Net tax	£7,670.15
Outputs	£77,770,127
Inputs	£77,035,169
EC Supplies	£13,627,523
EC Acquisitions	£31,764,217

78. On 28 July 2006 the period 06/06 return was submitted for a net repayment of £18,999.15, released at that time without further enquiry. The turnover for this period increased to in excess of £212,000,000, an increase in excess of £134,000,000, or 172%, on sales in the previous period. The details were as follows:

Output tax	£28,642,457.53
Acquisition tax	£0.00
Total output tax	£28,642,457.53
Input tax	£28,661,457.05
Net tax	£18,999.51 CR
Outputs	£212,422,681
Inputs	£211,887,495
EC Supplies	£48,751,496
EC Acquisitions	£47,988,000

79. HMRC concluded that Epinx's trading pattern in these periods had been manipulated to disguise the amount of input tax incurred by the company that can be traced back to defaulting traders.

80. In period 03/06 Epinx completed 83 deals as follows:

- 32 broker deals of which 28 were verified. All 28 traced back to one of the following defaulting traders: HJK Trading Ltd, The Export Co Ltd, SAS Fire and Security Ltd, Prestige 29 UK Ltd, DBP Trading Ltd or Eutex. HMRC was unable to establish the full deal chain of the remaining 4 deals.

- 39 acquisition deals of which 29 were verified. In all cases the goods were shipped back out of the UK. Of the remaining 10 deals, in 5 the goods were sold to Gee-Tec, 3 sold to Notebook Express Ltd and in 2 the goods were sold to Meridian Distribution Ltd. The 5 deals do not appear in Gee-Tec's records. HMRC do not hold records for Notebook Express Ltd or Meridian Distribution Ltd.

- 12 buffer deals of which 11 were verified and traced back to defaulting traders R & M Electrical, Eutex or Lesspot Cleaning Services Ltd.

81. In period 06/06 Epinx completed 233 deals as follows:

- 45 broker deals of which 44 were verified and found to trace back to one of the following defaulting traders: Eutex, 1st 4 Reports Ltd, Belling Appliances Ltd, PM Transport & Communications Ltd or Zenith Sports UK Ltd. HMRC could not establish the full deal chain of the remaining deal.

- 70 acquirer deals in all of which the goods were shipped back out of the UK by other broker traders including Waterfire.

- 118 buffer deals of which 116 were verified and found to trace back to defaulting traders Computec Solutions Ltd, UK Wide Computers or Eutex. In the remaining two deals goods were purchased by Epinx from Sabretone Electrics Ltd. HMRC noted that in all other deals where Epinx purchased from this supplier the goods were traced back to Eutex.

82. The effect of Epinx's contra transactions can be summarised as follows:

Month	Value of Broker Deals	Broker Deals	Value of Acquisition deals	Acquisition deals
January	£2,954,400.75	3	£2,913,212.50	4
February	£7,539,939.75	7	£7,442,332.50	13
March	£22,941,114.50	22	£22,250,747.00	22
	Total	32		39
PERIOD 03/06	**£33,435,455.00**		**£32,606,292.00**	
April	£2,138,598.00	2	£26,215,530.00	30
May	£17,109,023.25	17	£14,179,243.00	30
June	£29,333,027.75	26	£5,934,280.00	10
	Total	45		70
PERIOD 06/06	**£48,580,649.00**		**£46,329,053.00**	

83. HMRC noted that Epinx took over the business of associate company Pinx Ltd that became insolvent in February 2005 and of which Paula White was also a director. Pinx Ltd was visited by HMRC in March 2004 when Pauls White acknowledged she was aware of the problems with MTIC fraud. HMRC concluded that Epinx's trading had many features indicating that its transactions were artificially contrived, for instance a large number of the deal chains showed a high degree of consistency with the same traders appearing in precisely the same order and third party payments being present in the chains. Taken together with the significant rate at which the company's turnover increased, the lack of due diligence on its customers and suppliers, absence

of written terms and conditions save for purchase orders and invoices and lack of insurance for the goods HMRC concluded that Epinx's transactions lacked commerciality and that the company offset transactions to minimise its own tax liability and to enable claims to be made for the recovery of input tax by brokers in an attempt to defraud HMRC.

84. Epinx acted as the acquirer of the goods in each of the 5 supply chains. Mr Mody's verification of the 04/06 transactions established that there were certain features of these deals that were distinct when compared with Waterfire's other trading activity. In summary:

- The five purchases from Epinx on 29 April 2006 formed Waterfire's net claim for 04/06 in its entirety: the input tax incurred by Waterfire on those purchases (£1,265,567.63) accounts for 100.3% of Waterfire's overall net claim for VAT repayment for 04/06 (£1,262,625.13). Had the transactions not taken place Waterfire would instead have had a net liability to HMRC of £2,942.50;

- All five transactions took place on Saturday 29 April 2006 and were the last deals in Waterfire's VAT period to take place;

- The five transactions generated a total gross profit of £127,936 in one day. The average profit per unit was £9.80 as compared with its other average profit per unit in other broker transactions:

  (i) In 03/05 (one broker transaction): £3.00 per unit

  (ii) In 07/05 (three broker transactions): £3.29 per unit

  (iii) In 10/05 (seven broker transaction): £4.65 per unit

  (iv) In 01/06 (21 broker transactions): £2.47 per unit

  (v) In 04/06 (the remaining 27 broker transactions): £2.84 per unit

  (vi) In 07/06 (14 broker transactions): £4.64 per unit

- In two of the Epinx deals the goods in each supply chain were sold back to the company at the start of the deal chain: Nordic Telecommunications Denmark ApS which, from information received from the Danish Authorities, appeared to be a missing trader;

- Other than in these five transactions Nordic had never before featured as a supplier or customer to Epinx;

- Epinx failed to produce CMRs to support the acquisition of the relevant goods for each transaction;

- Epinx's suppliers during 04/06 included FAF International SRL, Gee-Tec Limited, Prime Telecom (UK) Ltd and Kiara Trading International SARL. Its customers included Prime Telecom (UK) Ltd, Coburg Trading SL, International Electrical Distributors Limited, Gee-Tec Ltd, Hennar SA and Kiara Trading International SARL. All of these companies featured directly in

Waterfire's supply chains during the period, three as direct suppliers to Waterfire in half of the transaction chains that were traced back to tax losses;

- In August 2006 Waterfire instructed Chiltern Plc to undertake extended due diligence checks on Epinx. Waterfire did not request any company to undertake this type of check in respect of its other suppliers. Chiltern's visit to Epinx took place on 7 August 2006 – 10 months after Waterfire's first trade with Epinx, three months after Waterfire's last transaction with Epinx and 10 days after it had ceased trading altogether.

85. HMRC officer White provided a witness statement regarding the trading activities of Epinx that HMRC considered to be a contra trader. In summary, the reasons for HMRC's conclusion were as follows: In the relevant period Epinx submitted a net claim for repayment for the period amounting to £18,995.51 yet its turnover exceeded £212,000,000. The figures declared on the VAT return show that the value of its sales and purchases were very similar.

86. Mr Mody drew the following further parallels between Waterfire's trade and that of Epinx:

- The exponential increase in Epinx's levels of turnover up to mid-2006 and its consistent ability to achieve profits on each of its transactions;
- The absence of manufacturers, official distributors, UK retailers and UK end-users in its identified supply chains;
- Its operation from a small premises with only a handful of staff;
- The use of an FCIB account for its wholesale electronic goods transactions;
- That defaulters and tax losses were identified in the supply chains of all its broker transactions;
- The identification of third party payments in a number of its supply chains.

87. Mr Mody noted that Waterfire's main customers were ToTel Limited ("ToTel") and ToTel Distribution Limited ("ToTel Distribution") that it supplied on 74 occasions. In all but six of those transactions Waterfire acquired the goods directly from an EU supplier and there were no direct tax losses in the supply chains.

88. Mr Mody highlighted one particular deal of Waterfire (deal number 209) in which on 21 April 2006 it purchased 3,225 Nokia 7380 mobile phones from International Electrical Distributors Ltd ("IED") and invoiced the onward sale to Spanish customer Proinserco SL on the same date. Waterfire subsequently issued a credit note to Proinserco dated 29 April 2006 indicating that the deal had been cancelled. On the same date Waterfire raised a second invoice at the same selling price to French customer Phones-C@nnected SARL. There was no indication that the goods moved out of Boston Freight BV in Belgium as a result of the goods being re-sold. When asked about this transaction by HMRC in a letter dated 12 July 2006, Mr Tahir responded on 19 July 2006 stating that the sale with Proinserco had been agreed and the goods shipped, however a VAT check of Proinserco established that its VAT number was invalid. HMRC's Electronic Folder showed that an attempt was made to

validate the number on 26 April 2006, five days after the invoice was raised and the goods dispatched. Proinserco was de-registered with effect from 26 April 2006. Waterfire had also validated the VAT number on the day of the deal on 21 April 2006 at which point it was told that the number was valid. Mr Mody could not identify a reason for a second check being carried out.

89. Mr Mody also noted that had this deal not been re-negotiated Waterfire's VAT liability at the end of the period would have increased from £2,942.50 due to HMRC to £152,501.88 due to HMRC (excluding the Epinx deals). Mr Mody also highlighted the apparent ease with which Waterfire re-sold the goods at the same price and without any apparent inspection being undertaken by the customer.

90. Mr Mody noted that Waterfire chose not to purchase from and sell to an EU customer thereby avoiding VAT consequences when it had established trading relationships with a number of EU companies as both customer and supplier.

Period 07/06

91. On 31 August 2006 Waterfire's VAT return for the period 07/06 was received by HMRC showing a net VAT liability due to HMRC of £3,926.63. The 07/06 return was not selected for verification by HMRC's systems however Mr Mody conducted a full analysis of the transactions.

92. In period 07/06 Waterfire carried out 31 deals as follows:

- 17 transactions in which it was the acquiring trader all of which were carried out in May; and
- 14 in which Waterfire acted as a broker trader, all of which were carried out in July.

93. Mr Mody noted that every broker transaction in June was traced back to defaulting trader ATPPTB Eutex. In every broker transaction in July ATPPTB Belling Appliances Ltd was the defaulter.

94. Waterfire's VAT declaration showed:

- Total Net Sales: £23,259,915.00
- Total Net Purchases: £22,953,399.00
- Net EU Supplies: £11,699,740.00
- Net EU Purchases: £11,419,400.00
- Total Output Tax (including acquisition tax): £4,021,425.64
- Total Input Tax (including acquisition tax): £4,017,499.01
- Net Liability Due: £3,926.63

Broker Transactions

95. Mr Mody traced all 14 broker transactions back to one of two hijacked traders: ATPPTB Eutex Ltd or ATPPTB Belling Appliances Ltd. The total tax losses at the foot of the relevant supply chains amount to £1,996,607.56 in respect of which assessments were issued to the respective defaulting trader.

96. The total net sales value of Waterfire's broker deals in 07/06 was £11,692,040. The gross profit it achieved on the 14 broker transactions amounted to £218,140 with the average unit profit being £4.64.

97. Taken in isolation the net effect of the 07/06 broker transactions placed Waterfire in a VAT repayment situation in the sum of £2,009,280.01.

Acquisition Transactions

98. For each transaction where Waterfire acquired directly from an EU supplier, an analysis of the company's VAT return shows that the appropriate acquisition tax and onward output tax was declared and accounted for.

99. The total net sales value of Waterfire's acquisition deals in 07/06 was £11,560,175. The gross profit it achieved on the 17 acquisition transactions amounted to £143,425.00 with the average unit profit being £2.54.

100. Taken in isolation, the net effect of the 07/06 acquisition transactions placed Waterfire in a position where it had a VAT liability of £2,023,060.63.

The net effect of all transactions

101. The broker transactions resulted in input tax claimable of £2,009,280.01 and the acquisition transactions resulted in output tax payable of £2,023,060.63. Excluding input tax on expenses the overall net effect was the submission of a VAT return showing a net due liability of £3,926.63.

Nature of trade

102. Waterfire's trading was conducted on a wholesale back-to-back basis. Generally Waterfire traded during the last ten days of each month. The company never made a loss on its transactions nor was it left with residual stock. In all 78 of its broker transactions the goods were never delivered directly to Waterfire's customer but instead were delivered to a third party freight forwarder or warehouse. In all but 12 of those deals the freight forwarder was based in a different country than that of Waterfire's customer.

103. As far as HMRC were aware, an officer of Waterfire never inspected the goods nor did they ever physically see the goods. At a visit by HMRC on 21 June 2006 Waterfire stated that inspections were undertaken at the premises of the freight forwarder or warehouse by either the warehouse keeper or a third party inspection company. Mr Mody noted that the inspections, when undertaken, consisted of a small percentage stock count and a cursory product inspection.

104. IMEI numbers were not retained where the goods traded were mobile phones. Mr Butt and Mr Tahir told HMRC in September 2006 that they specifically refused to obtain IMEI numbers or similar listings due to cost. Mr Mody noted that in a letter to HMRC dated 20 July 2006, following the issue of Budget Notice BN43 Waterfire

advised that it had taken the corporate decision to implement an IMEI verification/logging system, which was to be developed by Sci Tech Computers Ltd. Mr Sharif, an employee of Waterfire was director of a UK incorporated company called Platinum Security Group Ltd. His co-director was Mr Janjua who was also a director of Sci Tech Computers Ltd. Waterfire did not provide any information to show that an IMEI logging system was operational for the three deals carried out after the letter of 20 July 2006.

105. Mr Mody highlighted the high profit margins made by Waterfire on its EU purchases and EU sales (acquisition and broker deals) as compared with those made on its buffer deals:

<u>03/05</u>

Average profits per unit:

- on its two acquisition deals: £1.00
- on its four buffer deals: £4.50
- on its one broker deal: £3.00

<u>07/05</u>

Average profits per unit:

- on its one acquisition deal: £3.00
- on its twelve buffer deals: £2.91
- on its three broker deals: £3.26

<u>10/05</u>

Average profits per unit:

- on its six acquisition deals: £2.53
- on its eight buffer deals: £1.40
- on its seven broker deals: £4.65

<u>01/06</u>

Average profits per unit:

- on its 18 acquisition deals: £3.57
- on its seven buffer deals: £1.12
- on its 21 broker deals: £2.47

<u>04/06</u>

Average profits per unit:

- on its 47 acquisition deals: £3.21
- on its six buffer deals: £0.36
- on its 32 broker deals: £3.93

07/06

Average profits per unit:

- on its 17 acquisition deals: £2.54
- on its 14 broker deals: £4.64
- (no buffer deals)

106. During the course of its operation Waterfire made a total gross profit of £2,416,015.50 on its transactions.

107. Mr Mody highlighted information given by the directors during visits to Waterfire, which included the fact that Waterfire's customer insured the goods while they were in transit. Mr Mody queried why Waterfire's customer would elect to insure goods prior to payment or how this came about when Waterfire had not at that stage transferred title to the goods. He also noted that Waterfire stated it had marine insurance for stock held in storage. A copy of the policy was never provided to Mr Mody despite his request. Mr Mody stated:

"I haven't taken that from the point of view of the individuals' state of mind regarding that. I think the point I'm making here is in connection with the value of the goods, which in this case that I've quoted here is £79 million in this particular VAT period, and it just seemed surprising to me in respect of the value of the goods that insurance wasn't in place. So that's the inference I have drawn."

(Transcript day 4 page 73)

108. Mr Mody also exhibited a visit report dated 21 June 2006 which recorded Mr Butt as stating that Waterfire's supplier took out insurance and that Waterfire *"takes a gamble but weighs up pros and cons."*

109. In periods 04/06 and 07/06 Waterfire's goods in the UK were handled by six freight forwarders:

- Tec Smart UK Limited ("Tec Smart");
- Casa Freight and Removals Limited ("Casa Freight");
- Ontime Logistics (Kent) Limited ("Ontime Logistics");
- Marathon Services (Freight Division) Limited ("Marathon");
- JSA Logistics Limited ("JSA");

- Timothy Graham Fowler t/a Advance Solutions (“Advance Solutions”).

110. Tec Smart was only used by Waterfire in June 2006. Of Waterfire’s 14 transactions in that month, Tec Smart was the fright forwarder used on 11 occasions. On each occasion the goods were despatched to Entrepots Surete SARL in France. At a visit to Tec Smart by HMRC on 14 July 2006 the visiting officer overheard a telephone call being answered by a driver at Tec Smart’s premises as “Waterfire”. When asked about this the director he could not provide an explanation.

111. Casa Freight was used by Waterfire in its final six transactions in July 2006. The transactions were a mix of acquisition and broker deals and in all six the goods were again despatched to Entrepots Surete SARL irrespective of where the customer was based. The company was registered for VAT from 1 June 2006 to 2 June 2007. Casa Freight never submitted any VAT returns and was de-registered as a missing trader. Casa Freight and its associated companies Casa Commodities Limited, Casa Communications Limited and Casa Trading Limited, which all share a common director, were issued with decisions by HMRC to deny claims to input tax on the basis that each company either knew or should have known that its transactions were connected to MTIC fraud. The director of Casa Freight, Mr Rory Venables, was also a director of PMG Sunbeds Ltd that was de-registered as a missing trader with effect from 28 October 2004. Mr Venables’ co-director at PMG was Mr Steven Bradshaw who was subsequently appointed as the director of JSA while Mr Venables was the company secretary until October 2005.

112. JSA was used by Waterfire on at least 16 occasions during periods 01/06 and 04/06 in a mixture of acquisition and broker deals. Eight of the 16 transactions featuring JSA involved the goods either originating from or being despatched to Luxembourg Logistics of which two of JSA’s directors, Steven Bradshaw and Jamie Buxton were directors. Mr Buxton was also a director of Imex Logistics Limited, a freight forward/storage company used by Waterfire on 23 occasions between May and November 2005.

113. Waterfire used Ontime Logistics on 36 occasions during periods 04/06 and 07/06. The company was de-registered for VAT in November 2007 as a result of its failure to respond to requests for provision of records supporting its undertaking of taxable activity.

114. Waterfire used Marathon on 81 occasions in periods 10/05, 01/06 and 04/06 in a mixture of acquisition, buffer and broker deals involving CPUs and mobile phones. Marathon also occasionally inspected goods on behalf of Waterfire.

115. Waterfire used Advance on two occasions in period 07/06. The company’s VAT1 declared its trading activity as *“vehicle purchase and sales”*.

116. During periods 04/06 and 07/06 goods were purportedly despatched by Waterfire to seven different warehouse/freight forwarding companies in the EU:

- Entrepots Surete SARL;
- Luxembourg Logistics SA;
- Magic Transport BV;

- Boston Freight BV;
- MSG Freight BVBA; and
- ML & Co BV.

117. During 07/06 Waterfire undertook 14 broker transactions selling to six different customers. In each transaction, irrespective of the customer, Waterfire despatched the goods to Entrepots Surete based in France. In the remaining 17 transactions in 07/06 (in which Waterfire was the acquirer and not the broker) at least 11 of those transactions involved the broker trader despatching the goods to Entrepots Surete.

118. Boston Freight featured in at least 31 of Waterfire's deals in 04/06. It was also the despatching EU freight forwarder in all 17 of Waterfire's acquisition transactions during 07/06. From the information available to Mr Mody it appears that Boston Freight was not registered for VAT in Belgium. The company's director was Mr Marshal Boston, a UK resident who was also the director of UK freight forwarder Marshal Boston & Sons Limited.

119. Mr Mody was unable to find a VAT registration number for Luxembourg Logistics. The Luxembourg tax authorities advised HMRC that:

"…The company does not own trucks and realizes no transports. The heads of the company are Mr Steven Bradshaw and Mr Jamie Buxton, who are also the owners of the UK-based company JSA Logistics."

120. MSG Freight featured in seven of Waterfire's transactions. Waterfire's customers used MSG Freight on a further four occasions. The Belgian Tax Authorities reported that MSG Freight was used in carousel fraud and that the local VAT registration number was not known. The only VAT registration number identified was in the UK.

121. Two of Waterfire's direct tax loss deals involved Magic Transport in Holland. In both cases the UK supply chains were identical and featured the same defaulting trader at the foot of the chain. Magic and its director were subject to criminal investigation by the Dutch tax authorities in connection with MTIC fraud. The Dutch investigation revealed that over a period of time Magic falsely receipted a number of CMR documents in order to try to substantiate the movement of MTIC goods from the UK to their premises when the goods did not exist. It was also confirmed that where Magic had raised false documents purporting to show the onward movement of goods from their premises to other Member States, the premises of Magic was in fact a residential property.

122. ML & Co featured in 30 of Waterfire's deals. ML and its director are subject to criminal investigation by the Dutch tax authorities in connection with MTIC fraud. The Dutch authorities identified that over a period of time ML & Co falsely receipted a number of CMR documents to try to substantiate the movement of MTIC goods from the UK to its premises when the goods did not exist.

<u>Summary of trading</u>

123. Mr Mody highlighted the following aspects of Waterfire's trading in 04/06 and 07/06 as demonstrating the contrived nature of the deals and the lack of genuine commercial substance:

(a) the direct tax losses which featured in all of its broker transactions and which amounted to approximately £7,426,136.97;

(b) the repeated presence of missing and/or hijacked traders at the foot of the supply chains;

(c) the failure of Waterfire's due diligence to safeguard the company from chains tainted with MTIC fraud;

(d) the near-perfect balancing of its VAT liabilities over a six month period, despite a turnover of approximately £102,000,000;

(e) the construction of five transactions (the Epinx deals) on a single day at the end of period 04/06 which resulted in gross profit for Waterfire that day of £127,936 and which led to the submission of its net claim to input tax of £1,262,625.13;

(f) the closed group of EU participants featuring in Waterfire's supply chains, including freight forwarders, irrespective of the company's position in those chains as either acquirer, buffer or broker;

(g) the common principals and features connecting a number of those EU companies;

(h) the information obtained from tax authorities in other Member States;

(i) the identification of circular trading in at least two of the transactions whereby the goods originated from and were returned to the same Danish company in one day;

(j) the presence of third party payments in the chains;

(k) the flow of monies in the supply chains;

(l) the recurrence of traders and repeated patterns in the supply chains;

(m) the absence of any evidence to suggest that Waterfire had insured the goods; and

(n) the astonishing levels of turnover achieved by Waterfire from a standing start despite being a brand new company with minimal staff, achieving in excess of £186,000,000 in a period of trading lasting less than 22 months.

124. In cross-examination Mr Mody agreed that he has no direct commercial experience nor had he taken advice on how markets might generally operate.

125. It was put to Mr Mody in cross-examination that traders were expected to verify the existence of goods and one way to do so would be to take control of the goods and their transportation. Whilst Mr Mody agreed with the comment to a degree, he emphasised that in the case of Waterfire it had not personally taken control of the goods but rather a third party had been engaged to store and transport them. He clarified that the point he was making in his written evidence was that bringing goods

into the UK was not consistent with trying to maximise profits due to the unnecessary storage and transport costs.

126. On the issue of due diligence Mr Mody clarified that whilst Waterfire had carried out the type of checks HMRC would expect to see, the suggestions made in the public notices issued did not contain a definitive list of checks and ultimately the matter was one for each individual trader, not merely a means by which to satisfy HMRC. He also noted that in this particular case HMRC contends that Waterfire was knowingly part of an overall scheme to defraud the Revenue and as such the checks conducted by the company were irrelevant and superficial.

127. Mr Mody accepted that the figure contained on Waterfire's VAT return for 04/06 reflected the tax on supplies to the company and was arithmetically correct. He went on to say that HMRC contend that Waterfire's transactions were contrived as part of an overall scheme and, that being the case, Mr Butt was dishonest in submitting the 04/06 VAT return and in declaring the figures contained in the return which stated that he was entitled to the input tax. He summarised the role of Waterfire as a contra trader engaged in an overall scheme to defraud as follows:

"Well, in this particular case with Waterfire, it's quite odd. It's not a classic, if that's the term, contra-trader. We don't have a series of acquisition clean chains being offset by dirty chains, and we have an evened out net liability for this particular period, for period 04/06. We do have that in 07/06, but not in 04/06. In 04/06 we had the extra element of the five transactions with Epinx to which I've referred. The benefit to the contra-trader, if it can be described as such, if it was a classic contra-trader, it's not the contra-trader that is effectively trying to seek a benefit, if it can be put that way, it is the broker trader that is the recipient of the clean supply chain goods, if you can follow that, because that particular trader, the broker trader, would submit a net claim for repayment, which would prompt Revenue & Customs to initiate the verification process. In that situation we would trace the goods back through the contra-trader and, on the face of it, it would appear that those chains were clean and that there were no tax losses. So the benefit of contra-trading is not necessarily to the contra-trader, it's to the broker trader that is serviced by that contra-trader. Sorry, can I just qualify one more point? I do apologise. I suppose one other benefit is that the overall net liability for that company would be kind of set off and evened out. If there were only acquisition chains that were undertaken by the company, we would have a large VAT debt to HMRC to be paid. If it was only the dirty chains that the company undertook, there would be a large claim for repayment. So in a way, a benefit to the contra-trader is that it's offset its VAT liabilities."
(Transcript day 4 page 51)

Mr Lyon

128. Mr Lyon was responsible for making the decision to issue the penalty under Section 60 VATA 1994 against Waterfire for 04/06 that was subsequently transferred to Mr Butt and Mr Tahir under Section 61 VATA 1994.

129. Mr Lyon's written evidence set out the following factors that he took into consideration in reaching his decision to impose the penalties on Mr Butt and Mr Tahir.

(i) Pre-registration visit and Waterfire's application for VAT

130. It was noted by Mr Lyon that at a pre-registration visit on 11 August 2004 Waterfire was not making taxable supplies and was unable to provide evidence of an intention to do so. HMRC advised that evidence of taxable supplies was required before the application could be considered further. On 12 August Mr Butt telephoned HMRC and notified Mr Mody that he had lined up a purchase of DVD players. A fax dated 13 August 2004 contained the deal information and pro forma invoices for 2000 DVD players from JCP International in Hong Kong with Waterfire selling the goods to Demravale Limited in the UK. Based on this information Mr Mody allowed the registration to proceed. However during a visit to Waterfire on 28 September 2004 it was established that the intended purchase and onward sale did not take place and the first VAT declaration submitted was a nil return. Mr Lyon concluded that the documentation was provided as a means of obtaining VAT registration and did not reflect a genuine intended supply.

131. At an interview with Mr Lyon in 2010 both Mr Butt and Mr Tahir separately accepted that Waterfire did not trade in white goods nor did it retail any goods despite those activities having been declared on the VAT1 signed by Mr Butt. Mr Butt stated that the company had been set up with the intention of trading in mobile phones. When asked why this was not declared on the VAT1 he responded *"no reason."* A letter from Waterfire's representative at the time, Borders VAT Services Ltd, dated 28 July 2004 to Mr Tahir was exhibited by HMRC. The letter referred to the *"problem progressing the VAT registration"* as a result of vague descriptions on the VAT 1 and a lack of evidenced sales and purchases. The letter had been annotated and signed as *"agreed and understood"* by Mr Butt. The annotation seemingly made by Mr Butt next to the author's question "*who completed the VAT 1, did they know enough about your business?"* read *"Accountant/didn't have enough knowledge."*

132. Mr Lyon accepted in cross examination that in a telephone call with Waterfire's representative Border prior to the pre-registration visit, HMRC had been informed that the company was *"importing mobile phones and selling wholesale retail"*. However he stated his concern had been the information contained on the VAT1, which he had concluded was deliberately misleading in order for Waterfire to avoid HMRC's vetting processes of mobile phone traders seeking VAT registration.

133. Mr Lyon also took into account the anticipated turnover declared on the VAT1 of £900,000 in the first year of trade as compared with the actual turnover, which exceeded £8,900,000 and in the following year was £153,000,000. Again he had concluded that this information was deliberately misleading to assist Waterfire in obtaining a VAT registration number.

134. The VAT1 also stated that regular repayments were not expected yet documents received from Waterfire during the registration process indicated that at least half of their turnover would be zero rated sales.

(ii) Previous experience

135. Mr Lyon took account of the fact that Mr Butt had previously worked in businesses in which the risks posed by MTIC fraud would have been brought to his attention. Waterfire also employed Mr Shariff who would also have been aware of the risks of MTIC fraud as a result of his previous employment. Mr Lyon agreed that Mr Butt had accepted, during interview, that he was aware of MTIC fraud although he

could not say what the source of that knowledge was. He agreed that knowledge of MTIC fraud of itself did not indicate dishonesty.

(iii) Position of Mr Butt

136. Mr Lyon concluded that Mr Butt and Mr Tahir were the controlling parties of the company during period 04/06. He reached this conclusion on the basis that both said, in their respective interviews, that they received dividends from the company. Furthermore Mr Lyon noted that Mr Butt and Mr Tahir were the only shareholders and directors of Waterfire and thereby stood to benefit from any repayment made to the company by HMRC.

137. Mr Butt informed Mr Lyon that he had taken dividends totalling £35,000 by bank transfer in the financial year 2005-2006 and dividends totalling £135,000 in the financial year 2006-2007. When Mr Lyon checked Waterfire's HSBC bank statements he identified payments to Mr Butt and Mr Tahir of £205,000 each over the period January to July 2006.

(iv) Previous trading leading to tax losses

138. Waterfire was notified in November 2005 and February 2006 about tax losses connected to its transactions in periods 07/05 and 10/05. These transactions involved two of the same suppliers that Waterfire continued to trade with in 04/06.

(v) Structure of Waterfire's transactions in 04/06 and 07/06

139. Mr Lyon noted that in 04/06 Waterfire carried out both despatches and acquisitions and also bought and sold goods within the UK. He noted that the input tax denial in 04/06 of £6,900,000 could be split into two distinct elements:

> (a) Input tax amounting to approximately £5,700,000 denied in respect of purchases by Waterfire of goods that it sold to EU customers traced back to tax losses. This claim was largely offset by liabilities for output tax on Waterfire's acquisitions of other goods that were sold on, either directly or via buffer traders, to other broker traders who in turn submitted input tax reclaims on sales of the goods out of the UK; and
>
> (b) Input tax of approximately £1,260,000 which was denied in respect of five purchases by Waterfire from Epinx in which Waterfire acted as a broker trader.

(vi) Contra trading

140. It was the case for HMRC that Waterfire deliberately balanced its input and output tax as part of an overall scheme to defraud.

(vii) Epinx deals

141. Waterfire's purchases from Epinx gave rise to the whole repayment claim in 04/06. The value of VAT claimed in relation to those five deals was £1,265,567.63. All of the deals took place on Waterfire's last day of trading in 04/06.

142. Mr Lyon noted that the analysis of the money flows (more about which we will say in due course) showed parties receiving payments that were not in the flow of goods and two occasions of circularity of money flows.

(viii) Profit levels

143. Mr Lyon highlighted the differences in profit between Waterfire's contra, buffer and broker deals. Mr Butt explained these differences by reference to differing exchange rates and transport costs. Mr Lyon noted that all of the transactions were conducted in sterling and all of Waterfire's customers and suppliers used the FCIB where funds were always transferred in sterling. Mr Lyon queried why Waterfire chose to purchase goods from EU suppliers for re-sale to UK customers and why, where it did purchase from the EU, it did not sell directly to an EU customer.

(ix) Commercial checks

144. Mr Butt stated in his interview with Mr Lyon in February 2010 that Waterfire had *"done everything that Officer Mody told them to do"*.

(x) Penalty

145. Mr Lyon issued penalties against Mr Butt and Mr Tahir apportioned at 50% each of the penalty of 90% of the input tax denied in 04/06. He noted that neither had made disclosure and both maintained that they had not acted dishonestly. Having assessed the level of co-operation and disclosure he concluded that the behaviours and attitudes of Mr Butt and Mr Tahir were the same. Mitigation of 10% was applied to the penalty to reflect the fact that both men attended for interview.

Decision making process

146. In cross-examination Mr Lyon accepted that he had never personally worked in the mobile phone trade. He clarified the process by which his decision had been made and explained that the evidence gathered by Mr Mody played a significant part of that process by providing him with the material upon which his decision was based, although he emphasised that Mr Mody had not played a part in the decision to issue a civil penalty. Mr Mody was responsible for the decision to deny Waterfire's claim to input tax credits. Mr Lyon had also used a case adoption report prepared by HMRC officer Higgins, who did not give evidence, and he had reviewed a number of the underlying documents upon which that report was based. The decision to issue the penalty against Mr Butt was based on an offence report that followed the case adoption report.

147. Mr Lyon clarified that the only time he had met Mr Butt was during interview on 8 February 2010. He had not suggested to Mr Butt prior to the interview the type of irregularities in his tax affairs in respect of which HMRC sought disclosure and Mr Butt had failed during interview to raise any or engage with the process. He explained that he was not at liberty to disclose irregularities to Mr Butt as it could have affected the mitigation of any potential penalty.

148. Mr Lyon explained that he was not tasked to consider whether Waterfire's VAT return had been inaccurately completed by entering the wrong figures or a repayment claim made where no goods had been bought or sold. He looked at the circumstances in which the repayment claim was made and whether there had been dishonesty on the

part of the directors. He clarified that he took into account whether the directors were engaged in trading that caused tax losses to the Revenue and the fact that Waterfire acted as a contra trader formed part of that consideration.

Mr Millroy

149. Mr Millroy is an assistant director of Criminal Investigations. As part of that role he oversaw the review by Criminal Investigations from December 2007 to August 2008. He explained that the cases which were not taken forward by Criminal Investigations for possible prosecution were returned to Specialist Investigations. In cross-examination he stated that he has no actual knowledge of Waterfire or its individual circumstances nor does he have any knowledge of Mr Butt. He clarified that his role was not to consider whether or not Waterfire's VAT returns or claims for repayment had been honestly made.

Mr Lynch

150. Mr Lynch is an investigator with Specialist Investigations. He explained that between September 2008 and March 2011 he oversaw a review by HMRC of 1591 broker cases, of which Waterfire was one. The purpose was to review cases that had been rejected for possible criminal prosecution, with a view to possible civil intervention. Those that were not taken forward by Specialist Investigations (Fraud & Avoidance) were considered for action in respect of indirect tax, including a Civil Evasion Penalty. Mr Lynch stated that the case of Waterfire was not considered suitable for CIF (Civil Investigation of Fraud) because there was insufficient evidence of direct tax irregularities. It was later adopted for Civil Evasion Penalty action.

Ms Sharkey

151. Ms Sharkey analysed the FCIB accounts of Waterfire and tracked its financial transactions. Due to the number of transactions Ms Sharkey analysed a sample; in period 04/06 she analysed all of the chains in which Waterfire acted as broker and a selection in which Waterfire was the acquirer. In periods 01/06 and 07/06 Ms Sharkey selected those chains which featured different suppliers to and customers of Waterfire and analysed at least one transaction in which each customer or supplier featured.

152. For all of the transaction chains Ms Sharkey began her task by inspecting Waterfire's account, initially tracing the receipt of the money for the transaction identified from Waterfire to its suppliers. Ms Sharkey the traced the monies paid to Waterfire to the payer and the monies received by Waterfire to the recipient. This process continued where possible in respect of each particular transaction within the chain until the funds could not be traced with any element of certainty to another trader.

153. Ms Sharkey noted in her written evidence that for payments made after 1 May 2006 details of the IP addresses from which payments were made were available. The Paris server of the FCIB recorded the timings of payments and therefore the time gap between particular payments within a chain could be identified.

154. By way of example Ms Sharkey traced sales invoice reference 124 in period 04/06 and in which Waterfire acted as broker as follows:

Tracing forwards:

- On 23 February 2006 Waterfire raised a sales invoice under reference 124 showing a sale of 5,500 Samsung D600 with a sales value of £940,500. The goods were sold to Connected.

- All payments for this transaction chain took place between 2 and 13 March 2006.

- Waterfire sold the goods to Connected and received payments of £940,000 and £500 which equalled the sales invoice issued by Waterfire to Connected. The narratives for the payments were "5500 SAMD600" and "PENDING PON 5500 D600"

- Connected was able to pay Waterfire as it had received £940,000 and £2,150 from Avoset. The narratives for those payments were "5500 D600 DEAL" and "5500 D600 PEND".

- Avoset was able to pay Connected as it had received £940,000 and £3250 from GFSM. The narratives for those payments were "5500 D600 DEAL" and "5500 D600 BALANCE".

Tracing back:

- Waterfire was supplied with the goods by Epinx. The sales value on the invoice from Epinx to Waterfire was £1,079,237.50. Waterfire paid Epinx in two payments of £940,000 and £139,237.50 which together total the value of the invoice. The narratives to the payments were "PART 1 WATER REF PO143" and "PART 1 WATER REF PO143".

- Epinx paid Gee-Tec in two payments of £940,000 and £137,298.75. The narratives to the payments were "Part payment inv 0419" and "Balance of invoice 0419".

- Gee-Tec paid Sabretone Ltd in two payments of £940,000 and £135,360. The narratives were "PART PAY 0419" and "FINISH DEAL 0419".

- Sabretone Ltd paid Yodem Ltd in two payments of £940,000 and £127,605. The narratives were "Part pay 5500 x D600" and "d600s".

- Yodem paid Prabud in two payments of £940,000 and £127,605. There was no narrative for the first payment. The narrative for the second payment was "d600".

- Prabud paid GFSM in two payments of £940,000 and £126,305. There were no narratives for the payments.

- The payment chain diverts from the invoice chain at Yodem. Yodem purported to purchase the goods from PM Wholesale Ltd but payment was made to Prabud. As Yodem paid out exactly the same amount as it received it was not in a position to pay its VAT liability that would be due. Ms Sharkey notd that there were some small payments made by Yodem to a non-FCIB account in the name of PM Wholesale but it could not be ascertained as to what invoices the payments related to or whether they related to any of the Waterfire

transactions. Ms Sharkey also noted that on 11 March 2009 the director of PM Wholesale Electrical Limited, Mr Paul Makin was subject to a disqualification order preventing him from being the director of a company for 14 years commencing on 1 April 2009 for the following reasons:

(a) Mr Makin from 13 January 2006 to 31 March 2006 caused PM Wholesale to undertake a method of trade which involved it in and put HMRC at risk of being subject to MTIC fraud which resulted in a claim from HMRC for VAT revenues of £61,263,583. If Mr Makin did not so know, then he was reckless or grossly negligent as to whether PM Wholesale was concerned in such a fraud. In particular:

(i) Between 13 January 2006 and 31 March 2006 Mr Makin caused PM Wholesale to enter into transactions for the purchase and sale of mobile phones and computer software, from UK based companies and sold these goods on to other UK based companies for at least £440,807,094.81 including VAT of £65,120.51;

(ii) Mr Makin traded with UK companies between the period 13 January 2006 and 31 January 2006 without PM Wholesale being registered for VAT making purchases of £29,272,918.73 with VAT of £4,359,796.41 and sales of at least £29,468,751.02 including VAT of £4,388,962.92;

(iii) Mr Makin failed to ensure PM Wholesale made appropriate checks on suppliers with HMRC's Redhill VAT office before commencing trades, despite being requested to do so by HMRC;

(iv) Mr Makin caused PM Wholesale to issue payment instructions to its customers placing the company in a position whereby it had insufficient funds to meet its VAT liability to HMRC.

- Ms Sharkey noted that the fisrt payment in this transaction chain appeared to start with Waterfire and took 1 hour 9 minutes to complete the circle. The second payment began with GFSM which received £123,055 more than it paid out for the transaction.

155. Ms Sharkey concluded from her analysis that there were financiers in the transactions: GFSM and Nordic.

156. Ms Sharkey also noted the following similarities and connections between companies in the transaction chains:

(i) A significant proportion of the companies in the supply/money chains have a connection to Malaga;

(ii) Four of the companies (Nano Infinity, Microzero, Zorba Sro and Regent Sp zoo) are run by the same individual and although they are registered for VAT in different locations (France, Spain, Slovakia and

Poland) they appear to all be run from the individual's home address in Marbella, Spain;

(iii) Three companies are run by Alexis Leroy (Estocom, Valdemara and Proinserco). The companies are based in Estonia, Latvia and Spain but all have a mailing address in Spain which appears to be the home address of the director;

(iv) The Neuvonen brothers are the directors of FAF and Avoset but also previously worked alongside Mr Broberg at Powertech Engineering in Marbella. Mr Tommi Neuvonen is listed as the contact for Coberg. Mr Broberg controlled a bank account containing sub-accounts in the names of these companies and from which payments were made to the personal accounts of Alexis Leroy, Niclas Rook and Jose Leon;

(v) GFSM featured in 44 of the 53 chains sampled. The companies run or owned by Alexis Leroy, the Neuvoven brothers, Christopher Shae, Sebastian Davila, Gilles Poelvoorde, Martin Vabn Der Ven, Jose Leon, Joakim Broberg and Lukas Matula feature in the majority of chains with the companies run by them introducing the goods to the UK and removing them from the UK;

(vi) In some of the chains companies owned by the same director have purchased goods in more than one part of the chain;

(vii) A number of the companies regularly used the same IP address in making payments for instance GFSM in Hong Kong used the same IP address as Regent (Poland), FAF (Italy), Prabud (Hungary), Elandour (France), Scorpion (Portugal), Connected (France), Avoset (Estonia), Estocom (Estonia), Kiara (France), Nano (France), Universal (UK), Zorba (Slovakia) and Hi-Lo (Sweden).

157. In support of her conclusion that there was an overall scheme to defraud the Revenue Ms Sharkey highlighted the circularity of funds in all sampled deals for which sufficient information was available in tracing the money chains. She also noted the connections between directors and companies, use of common IP addresses by different companies and the presence of third party payments in the chains.

158. In cross-examination Ms Sharkey clarified that HMRC had checked with the bank that the timings contained on the Paris server showing payments made by different traders in different geographical locations all related to the same time zone.

159. Ms Sharkey was cross-examined as to her qualifications and confirmed that she had not prepared her written evidence as an expert. She explained that her use of the phrase *"…witness statement made in support HMRC's appeal"* was not intended to suggest any bias or predetermined ideas as to the outcome of her tracing exercise.

160. As to the sample of deals analysed Ms Sharkey explained that for periods 01/06 and 07/06 she chose deals involving a different customer and/or different supplier in each chain to try to show a cross-range of the traders Waterfire traded with. For period 04/06 Ms Sharkey traced all of the broker deals and a random selection of acquisition deals which numbered too many to trace each.

161. Ms Sharkey agreed that Waterfire did not make third party payments nor had they shared an IP address with other traders in the money flow chains. As to connections between traders and companies Ms Sharkey clarified that Waterfire had not been closely associated with traders in the chains in the way that other individuals and companies had, for instance Waterfire had no connection to Spain.

Mr Fletcher

162. Mr John Fletcher is an independent consultant subcontracted to KPMG LLP ("KPMG"). He was instructed by HMRC to assess:

- The nature and extent of the authorised white market in mobile phone distribution, having regard to the position in both 2005 and 2006;
- The nature and extent of the non-authorised or "grey" market(s) in mobile handset distribution, including in the EU and UAE, having regard to the position in both 2005 and 2006 regarding import (acquisition), export (despatch) and UK to UK deals, including: opportunities for grey market trading; and identification of actual and/or hypothetical profit-maximising behaviours that may be expected in grey market trading in each of these three types of activity; and
- Waterfire's trading in mobile handsets in 2005 and 2006 as compared with the analysis of the grey market(s), including:

    (i) Waterfire's deal structures;

    (ii) Waterfire's market share(s);

    (iii) The documentation supporting Waterfire's sales and purchases having regard to the transactional documents;

    (iv) Any other aspect of Waterfire's trading behaviours.

163. Due to the detailed and partly generic nature of Mr Fletcher's statement we have limited the summary that follows to the main issues taken with his evidence.

164. Mr Fletcher provided the following description of the grey mobile phone handset distribution market:

"The mobile phone handset industry is international in nature and this presents further opportunities for distributors to take advantage of international market failures in what is commonly referred to generically as "the grey market". The grey mobile phone handset distribution market arises from the failure of the authorised mobile phone handset distribution market to meet fully the needs of certain participants in that market, with many buyers and sellers taking advantage of the opportunities presented by this market failure…There are two categories of market failure in the distribution market: price-related market failures and volume related market failures."

165. Mr Fletcher explained that price-related market failures give rise to two forms of market opportunities; arbitrage and box-breaking. Arbitrage takes advantage of the opportunity created by differentials in the gross price between countries and box-breaking takes advantage of differences between gross and net (i.e. subsidised) prices. The volume-related opportunity occurs as a result of over or under-stocking by the authorised distributor (AD) or the retailer. When the retailer under-stocks, volume shortages arise, and when the AD overstocks the dumping (i.e. sale of old stock which is now surplus to current requirements) opportunity arises.

166. The following table provides a useful summary of the characteristics and negative indicators of grey market trading:

Opportunity	Characteristics	Negative indicators	Common negative indicators across all opportunities
Box-breaking: Exploiting non-uniform handset subsidies by MNOs	Fundamental to business model is purchasing subsidised handsets. Distribution channels in countries with no or low subsidies. Hundreds of staff to collect and reconfigure handsets required. Box-breaking activities and resulting stock would need to be housed in a central repository or multiple warehouses.	Trading in non-subsidised handsets (or not sourced from a country with high subsidies e.g. UK). Importation of European 2 pin handsets into the UK. Lack of sufficient labour and warehouse facilities. Lack of stock.	Unreasonable high volumes of specific handsets compared to the total volume sold through non-OEM channels. Inadequate product specification on handset purchase orders and invoices.
Arbitrage: Exploiting gross pricing differentials of handset unit prices across countries	Current knowledge of the OEM price differentials in the geographic markets is required. Multiple similar	Trading of a product with homogenous pricing in all territories e.g. Nokia. Lengthy supply chains, which would erode the	Unreasonable high volumes of specific handsets compared to the total volume sold through non-OEM channels.

	shipments to the same customer from same source. No requirement to hold stock and bear associated stock handling risks. Relationships with Ads at a minimum in each country to maximise profit.	small margins available for this market opportunity. Allowing new traders to enter and persist in an established deal chain.	Inadequate product specification on handset purchase orders and invoices.
Volume shortage: MNOs and large retailers under-estimate demand for a particular product	Stock ownership (or near-stock ownership) through speculative purchasing. Evidence of written responses to the MNOs RFP. Relationships with the MNOs is required to be on RFP lists. A commercial structure in place to respond as an emergency supplier.	No speculative purchase of stock.	Unreasonable high volumes of specific handsets compared to the total volume sold through non-OEM channels. Inadequate product specification on handset purchase orders and invoices.
Dumping: Distributors over-estimate demand for a particular product	Speculative purchase of stock. Deals are initiated by the distributor and are single transactions, usually "one-off" aimed at territories where there may still be some demand for the product. Sourced from distributor's own stock. Relationships with overseas distributors and retailers.	Trades initiated by customer requests. No ownership of stock. Purchasing from suppliers other than OEMs or Ads despite having sufficient volume to secure those relationships and supply chains.	Unreasonable high volumes of specific handsets compared to the total volume sold through non-OEM channels. Inadequate product specification on handset purchase orders and invoices.

167. Mr Fletcher commented on the structure of Waterfire's deals. He based his analysis on information provided by HMRC which contained the following:

- An electronic spreadsheet summarising 244 deals involving goods that Waterfire traded between October 2004 and July 2006, of which:

- 151 (62%) of these 244 deals involved trades of mobile phone handsets. It is these deals that were the subject of Mr Fletcher's analysis. The spreadsheet contained details of the quantity, model, value and counterparties involved in the 151 deals.

- Of the 151 deals, 88 deals in 2006 were also listed in a separate series of electronic spreadsheets which contain further information concerning deal chains and the parties further removed from Waterfire which featured in the deal chains.

168. Mr Fletcher found that Waterfire's deals featured characteristics that indicate that there is potential for arbitrage trading. These features include not holding stock, patterns of trade and staggered release of handsets. Mr Fletcher highlighted that the deal information for all 6 deals analysed which involved domestic trades shows that Waterfire purchased and sold handsets on the same day. He also noted that the deal information relating to Waterfire's import and export trades shows that a number of deals took more than one day for Waterfire to buy and then sell the handsets. In 29% of import deals and 90% of export deals in which Waterfire held stock for less than two days, Mr Fletcher noted that stock holding appears consistent with arbitrage trading. For 47% of import deals stock was held for more than two days but less than one week which is also consistent with arbitrage trade. 24% of import deals and 10% of export deals took more than one week to complete which Mr Fletcher observed is not ideal from the perspective of arbitrage trade because of the risks associated with stock holding, however it is not inconsistent with arbitrage trade.

169. Mr Fletcher noted that Waterfire's pattern of trading by repeating transactions with the same counterparties over a period of several days or weeks then establishing chains with different counterparties and following the same pattern is consistent with arbitrage trading.

170. 27% of the volume of phones traded by Waterfire were traded within six months of them first going on sale to the public and were Nokia models. Mr Fletcher considered it possible that Waterfire was taking advantage of staggered release arbitrage opportunities. By way of example the Nokia N70, traded by Waterfire in December 2005, was first sold to the public in September 2005. However Mr Fletcher concluded that the level of detail on Waterfire's invoices means that it was highly unlikely that Waterfire was pursuing a staggered release arbitrage opportunity.

171. Mr Fletcher noted that whilst Waterfire's trading featured characteristics consistent with arbitrage trading, it also featured many characteristics that are not indicative of rational and profitable arbitrage trading. One such characteristic was the fact that in the 151 deals analysed 76% of phones traded were Nokia. Mr Fletcher explained that Nokia sets identical wholesale prices in all geographical markets and therefore he considered the Sterling to Euro exchange fluctuations alone would be insufficient to support arbitrage. He noted additionally that currency fluctuations would have no bearing on the potential for profit in domestic trades.

172. Between January 2005 and July 2006 in the 151 deals analysed, Waterfire traded 461,010 handsets, including 348,997 Nokia handsets. Mr Fletcher observed that the best option with respect to sourcing these phones, given the volume of trade, would have been direct from the Original Equipment Manufacturers ("OEM") (Nokia) or, if not possible, Authorised Distributors ("AD"). Mr Fletcher noted that

there was no evidence to suggest that Waterfire attempted to negotiate the supply of stock from either Nokia or, where the supplier was UK based, ADs. Mr Fletcher concluded that there is no apparent commercial logic behind Waterfire's decision not to source such large volumes of goods from an AD. The commercial benefits of working with ADs are so compelling and the risk of working from personal contacts so high as to make Waterfire's choice inconsistent with rational profit maximising behaviour.

173. Mr Fletcher noted that for rational and profitable arbitrage to take place supply chains need to be kept as short as possible. Waterfire's chains were too lengthy to keep profitability at reasonable levels in all of the companies in the chains and the average mark-up earned by Waterfire of 1.74% is unusual and inadequate in comparison to the risks and effort required to complete the deals.

174. In the 151 deals analysed Waterfire traded 426,010 handsets. Mr Fletcher considered it unusual for the European and UAE market share of any one company to exceed 5% yet in 10 instances (14%) of Waterfire's deals its market share exceeded the total addressable market opportunity in a particular month. In a further 63 instances (65%) Waterfire traded at a market share greater than 5% but less than the entire market available. Mr Fletcher concluded that the market share levels achieved by Waterfire in these 73 instances, representing 79% of the volume of handsets traded during 2005 and 2006 were not tenable.

175. In order to pursue the profitable arbitrage market it is vital that an appropriate level of detail is contained on purchase orders and invoices. The minimum must include information regarding handset model and variant (such as colour), the region covered by the warranty and the absence or inclusion of charger, battery, CD and manual. Mr Fletcher noted that failure to specify handsets correctly could have disastrous financial consequences and whilst adaption is possible, this could exceed £5 per unit. From the 151 deals analysed Mr Fletcher took a sample of 42 deals to review the documentation. He concluded that the specification on Waterfire's purchase orders and invoices was inadequate. The documents failed to refer to variants such as colour, charger type, warranty or absence or inclusion of CD, manual or phone/manual languages. He noted that Waterfire used the decsriptins "C/E spec" and "Euro spec" to describe the Nokia phones. However Nokia does not use these descriptions and they would not help traders to adequately identify stock.

176. The domestic trades undertaken by Waterfire cannot be characterised as arbitrage trading, which involves trading between one market and another where there is a difference in price for the same product. Mr Fletcher noted that in 7 of the 42 deals reviewed, the dates on documents are inconsistent with the chronology he would expect; by way of example there were four instances in which Waterfire produced purchase orders after the suppliers had invoiced it and three instances in which Waterfire's invoice was produced prior to the purchase orders of its customers.

177. Collectively Mr Fletcher considered that the negative features were overwhelming and indicated that Waterfire's trades were extremely unlikely to be part of the rational and profit-maximising arbitrage market.

178. As to other grey market opportunities, Mr Fletcher considered the likelihood that Waterfire's trading utilised such opportunities. He reached the following conclusions:

- There is no evidence and it is extremely unlikely that that Waterfire was exploiting box-breaking opportunities;

- There is no evidence and it is extremely unlikely that that Waterfire was exploiting volume shortage opportunities;

- Although in 20 instances the age of the handsets traded is consistent with dumping, it is extremely unlikely that Waterfire operated under this grey market opportunity.

179. In cross examination Mr Fletcher confirmed that he was giving evidence as an expert and although his statement makes no reference to the duties of an expert witness he clarified:

"I think this comes back to the start of my involvement. I'm aware that CPR35 does contain those statements. I would characterise this evidence as being consistent with the general provisions of, I think it's paragraph 4 of CPR35, that is that I am an independent expert, I have provided all the information that's within my knowledge and relevant to the tribunal. I have offered and will continue to offer that evidence independently, even if my evidence could be construed as being unhelpful to the case of HMRC. And where new information has come to light, I have on a number of occasions issued supplementary statements, gone back to the tribunal and told them of this, and provided where I believe to be a consistent presentation of the best of my knowledge and belief... As I say, I was guided by partners at KPMG and indeed by the solicitors office at HMRC as to the format of the wording."

180. Mr Fletcher confirmed that he is a Chartered Accountant and that he has never traded in the grey market. Mr Fletcher's conclusions were based on his knowledge of the market for the distribution of handsets.

181. Mr Fletcher agreed that maximising profits was a paramount consideration, but not the only consideration for traders in the grey market:

"Q. For example, I think a lot of your conclusions are based on the assumption that humans are rational and rationality means maximising profit?

A. They are based on the fact that it's rational to maximise profit. I'm not sufficiently expert to go along with the statement that humans are rational.

Q. Fine. That's exactly the point, humans aren't rational, are they?

A. I don't know.

Q. People very often act for reasons other than simply to maximise profit?

A. They may, although I'm of the view, and it's a non-expert view, that people generally act out of self-interest, particularly in commerce.."

(Transcript day 6 page 34)

182. Mr Fletcher agreed that in January 2012 he was aware of delays in HMRC making repayments but stated that this did not impact on the conclusions he had

reached. He accepted that a delayed VAT repayment claim may impact on a trader's cash flow and as a consequence the trader's trading patterns. As to whether offsetting could assist with cash flow problems, Mr Fletcher said the following:

"That would, to my mind, be an imprudent means of trying to deal with the cash flow issue. Just importing goods because it gives you an offset by itself doesn't help. There has to be a demand for those goods. If one considers that VAT is only, I think in 2006 it was 20 per cent, but it is only 20 per cent of the value. If you've imported goods on even perhaps quite generous trade credit terms, you still have to pay for them, so you're left with something that cost you four times the VAT that you're trying to save, and I would argue that if you're facing cash flow difficulties, the most sensible thing to do would be to look for conventional commercial finance, either through an overdraft or through invoice factoring to try and improve your cash flow. But importing goods to offset them when you're then left holding these goods -- and it need not be mobile phones, it could be anything that simply generates the VAT on input, I think would not be a prudent course of action."

(Transcript day 6 page 40)

183. Mr Fletcher was asked how a trader would know that the grey market was international. He explained:

"As I've said, because there is information in the public domain that explains how these trading opportunities exist, and that information would have been available to the participants in the grey market, irrespective of their size, and I would submit when there are articles in trade publications like Mobile News explaining how grey market trading opportunities have arisen, explaining that OEMs are taking action against authorised distributors that appear to be in breach of agreements with them, that it's clear where these opportunities exist, that in the United Kingdom on every high street there was a ready source of highly subsidised prepaid phones and that many people in the grey market knew that these phones were being exported to countries with little or no subsidy. I think it would be quite clear to any participant, irrespective of their size, that this market had a very, very large international administration to it."

(Transcript day 6 page 48)

184. Mr Fletcher clarified his use of the phrase "adding value" by which he did not mean something done to the mobile phone but rather that the middlemen add value to their counterparties by their presence and from that, derive a profit.

185. In cross-examination Mr Fletcher agreed that he had not considered the impact of VAT administration and how it could potentially have affected trade, he was therefore unable to comment as to whether such a factor would undermine his conclusions or not.

Mr Humphries

186. Mr Humphries is an employee of HMRC who reviewed deal sheets detailing the transaction chains of Waterfire in periods 04/06 and 07/06. He analysed the information on the deal sheets to determine the overall nature of the transactions

undertaken by the various traders involved. Mr Humphries concluded that the trading pattern indicates that the transactions were contrived. He noted that in the acquisition deals, 6 of Waterfire's 8 EU suppliers also feature at the other end of the transaction chains as customers of the brokers. The goods acquired by the UK contra traders and passed though the UK were mostly purchased from the UK brokers by the same group of EU traders who had supplied them to the contra traders in the first place. The goods appear to have been deliberately kept within a small group of traders with their destination being dependent on their origin.

187. Mr Humphries noted that there are 10 customers in Waterfire's despatch or broker transactions, 8 of which also feature as suppliers or customers in its acquisition transactions. He queried why Waterfire found it necessary to physically import the goods in its acquisition deals into the UK to sell to UK customers when the goods could have been sold to EU customers already known to Waterfire at a greater profit.

188. Waterfire's transactions in 07/06 had similar features to those in 04/06 in that most of the same traders are involved. Mr Humphries outlined two distinct patterns of trade; first, the May acquisitions are offset by the June broker transactions. Second, the June acquisitions were offset by the July broker transactions. In each set of transactions the values of input tax and output tax were closely matched and the customers in Waterfire's broker transactions matched those of the brokers in its acquisitions. Mr Humphries concluded that this is not consistent with genuine arm's length commercial trading.

189. It was the case for HMRC that Waterfire's transactions formed part of a larger overall contra trading scheme involving 11 contra traders who operated in concert. The goods traded were kept with the same small group of EU traders and appear to have been coordinated under a single direction. Mr Humphries reviewed the deal sheets of the other 10 contra traders in April, May and June 2006 and found that their transactions followed the same pattern as those of Waterfire. The transactions were arranged so that the output tax due on the acquisitions was balanced by the input tax claimable on despatches (the overall input tax figure is almost 99% of the output tax). The despatches all feature tax losses almost identical to the input tax amounts, they all have common EU suppliers and customers, and the same EU customers feature in both acquisitions and despatches.

190. In cross-examination Mr Humphries explained that by the term "contra-trader" he meant a trader which undertakes two types of transactions; goods purchased from overseas which are generally sold in the UK and upon which there is no input tax to claim but output tax on the onward sale, and goods purchased in the UK and sold out of the country upon which there is input tax to claim from HMRC but no output tax to pay because the sale is zero-rated for VAT. The liabilities on those two types of transactions are netted off on the trader's VAT return. He added that it is the defaulter rather than the contra trader who fails to pay tax but the connection to that loss exists via the tax loss in the direct chain of supply leading to it. Mr Humphries clarified that the fact that Waterfire was a contra trader was not the basis for his conclusion that it was involved in an overall scheme to defraud but the fact of its transactions, what it did and what the other contra traders did:

"…it's hard to separate them because Waterfire has bought goods from a series of EU traders. The goods themselves filter through the UK and, in large part, go back to those same EU traders. That appears, to me, to be contrived trading."

(Transcript day 6 page 157)

191. Mr Humphries explained that he had considered whether there might be a commercial reason for the pattern of trading:

"...I looked at the prices, the goods coming into the UK and the goods going back out to the UK, and the fact that the EU traders always seemed to be selling low into the UK and buying high out of the UK, the same goods in a relatively short time, it didn't seem commercial to me."

(Transcript day 6 page 165)

192. Mr Humphries clarified that he could not comment on the dishonesty of the Appellant and accepted that they had never met. He did not know who controlled the scheme and could not go so far as to say it was Waterfire although he concluded that every trader in the scheme must have known that it was being controlled, i.e. who to buy from and who to sell to.

Mr Stone

193. Mr Stone clarified in oral evidence that his witness statement makes no specific reference to matters relating to Waterfire. He explained that there was no requirement to send a notice to taxpayers regarding HMRC's use of abuse arguments to deny refunds.

194. Mr Stone explained the beneficiaries of MTIC fraud as follows:

Q. So who are you saying are the primary beneficiaries?

A. The other parties in the transaction chain, the buffers and the exporters… And those that are the conduits and those that introduced the capital into the fraud.

Q. How did those who introduced the capital profit?

A. They take a slice of the stolen VAT as well.

Q. Where did they take that from?

A. It's paid back to them as part of their profit.

Q. Profit from?

A. The -- supposedly buying and selling.

Q. Okay. So --

A. The first trader in the chain is an overseas company that introduces the capital, that capital passes down the chain until it arrives to the UK exporter. The UK exporter adds the VAT, it goes down the chain, doesn't go to the missing trader, gets paid off the third party, the money goes back to the original investor, the original investor takes his original capital plus his profit, which is a share of the stolen VAT."
(Transcript day 7 page 52)

195. It was put to Mr Stone in cross-examination that traders may not have been aware of the type of enquiries expected of them by HMRC. Mr Stone responded:

"…You've already made the point that the appellant is in business and apparently an experienced businessman. You would expect him to know what checks to make."

(Transcript day 7 page 65)

Mr Butt

196. Mr Butt did not give oral evidence, an issue that we address in more detail in due course. However there were two witness statements signed by Mr Butt and these are summarised below.

Summary of Mr Butt's witness statements

197. Waterfire was an off the shelf company purchased with the intention to trade in white goods, consumer electronics (including mobile phones) and to retail its products. Mr Butt had been involved in the telecommunications sector of wholesale consumer electronics since graduating and he had met and befriended Mr Tahir at his place of employment at 20:20 Logistics. Initially the plan was to trade locally within the UK but as the company became more confident and streamlined, it grew to export and import markets. HMRC's case is based on the assumption that everyone who traded in the mobile phone sector knew or should have known of the fraud in the industry. Mr Butt was aware of the prevalence of fraud and as a result he adopted particular practices in his trading style to safeguard against fraud and which followed the guidance given by HMRC in its public notices.

198. Waterfire did not deal directly with any missing traders nor did Mr Butt act dishonestly. Intense due diligence procedures were carried out in order to mitigate the risk of involvement with fraud. Mr Mody had agreed that the company was doing all that it could to avoid connection with fraud. If Waterfire was notified of tax losses in its chains, it avoided trading with the respective supplier in the chain.

199. As a consequence of HMRC's policy of delaying or denying input tax on mobile phone transactions and the information imparted by HMRC to traders generally Waterfire preferred to by from the EU and sell into the UK to minimise the risk of not being paid by HMRC. Waterfire tried to roughly match imports and exports to avoid cash flow disadvantages.

200. Waterfire made a commercial decision to import stock after consultation with Mr Mody. The due diligence carried out on all trading partners comprised an exhaustive and lengthy criterion of checking the companies. Mr Butt cannot comment on information regarding other traders who are outside of his knowledge or reach. Documentary evidence demonstrating the due diligence cannot be produced as the company records were in a vehicle that was stolen (crime reference 115277b/09). It is accepted that the crime report makes no reference to the documents but just because the detail of what was inside the vehicle was not mentioned does not mean the assertion is incorrect. Additionally Mr Butt's former representatives have refused to release documents to him as a result of a dispute over fees.

201. Waterfire was wound up in 2010/2011 as a result of complaints made by other businesses relating to credit purchases. These complaints had nothing to do with the Appellant or Mr Tahir as a new owner and director had taken over in 2009.

202. HMRC's case is based upon the opinion of witnesses who have had limited or no contact with Mr Butt. Mr Butt is not aware of the term "contra trader"; every transaction undertaken received the same due diligence practices that were incorporated by Waterfire from the time it started trading. Waterfire did not make or accept third party payments and always had freight companies inspect and verify its stock. Every deal had an inspection report and a copy of the CMR freight record.

203. Mr Butt denied that he had any actual knowledge that fraud was taking place; there is no direct evidence of this such as an email, letter or other document. The evidence is circumstantial and does not demonstrate Mr Butt's actual knowledge of or involvement in a fraudulent scheme.

Submissions

The Appellant's submissions

(i) HMRC's misconstruction of relevant legal provisions

204. It was submitted by the Appellant that HMRC's case is misconceived as a matter of both law and evidence. HMRC have attempted to use sections 60 and 61 VATA 1994 in a manner which was entirely outside Parliament's contemplation when the provisions were enacted; the sections were not intended to penalise a person for claiming input tax actually incurred.

205. The Appellant is subject to a penalty in the sum of £3,137,483.04 as a result of submitting a VAT return on behalf of Waterfire that included a claim for VAT in the sum of £6,972,184 on supplies made to Waterfire. There is no dispute that the supplies were made and VAT incurred by Waterfire in acquiring the supplies or that the supplies were for the purposes of Waterfire's business.

206. The suggestion that there was any case law to suggest that entitlement to input tax could be refused in circumstances where it was incurred for the purposes of a business is erroneous. HMRC are wrong to suggest that *Optigen* made the legal situation clear such that the Appellant could have known on 15 May 2006 when the return was submitted that Waterfire was not entitled to deduct input tax.

207. At the date on which the return was submitted the only authoritative statement on the issue was the opinion of Advocate General Ruiz-Jarabo Colomer in *Kittel*, when applied to this case it stated that providing Waterfire did not participate or derive any benefit from the transaction, as a matter of law it was entitled to claim input tax. Knowledge of any such fraud did not amount to participation.

208. It was submitted that only if the Appellant was dishonest in making a claim for input tax on behalf of Waterfire can he be penalised for making that claim.

(ii) Right to a fair trial

209. The overriding objective for the Tribunal is to ensure that the hearing is dealt with in a manner that is fair and just. The appeal involves a criminal matter for the purposes of the ECHR and EU Charter.

210. Article 6 of the ECHR applies to the appeal. The Upper Tribunal refused leave to appeal Judge Blewitt's summary judgment issued on 20 may 2014 but held that "the merits of the respective arguments should be properly considered by the FTT at the substantive hearing." The consequence is that having decided that HMRC's arguments were not fanciful, it must now decide if they are merely wrong. In doing so the Tribunal must approach the issues with an open mind.

211. It was submitted that as a result of Judge Blewitt's summary judgment decision, refusal of leave to appeal on 28 May 2014 and decisions on disclosure a fair minded and informed observer would conclude that there was a real possibility that she has pre-judged a major part of the issues in the appeal. In particular Judge Blewitt has pre-judged the central issue as to whether Waterfire's actions in trading were explicable as a consequence of an HMRC policy. This policy created considerable commercial disincentives to conducting trade in a way which would require a claim for VAT repayments from HMRC; the conclusions of the HMRC officers giving evidence to the contrary effect were fundamentally undermined by their failure to consider this policy.

212. By suggesting that the only relevant issue was the Appellant's state of mind, the fair minded and informed observer is likely to conclude that Judge Blewitt has formed the view that Waterfire and/or the Appellant's conduct is to be regarded as objectively dishonest. This goes to the heart of the Appellant's challenge to the circumstantial evidence of HMRC to the effect that the Appellant should be considered dishonest.

(iii) Equality of arms

213. The treatment of the disclosure applications raises a separate point on the breach of the Appellant's Article 6 rights. The right to legal representation requires that legal representatives are given sufficient time to properly raise and address issues which are relevant to the proper presentation of the case. The Tribunal's approach of requiring the Appellant to justify the relevance of materiality to an extent which is unrealistic, given the resources available to the Appellant and the Tribunal's decision to proceed with the substantive hearing on 16 June 2014 denied the Appellant adequate time to appeal inadequate disclosure directions. The judge acknowledged the difficulty of determining such issues before the Appellant's witness statement and list of issues was served. If full disclosure is not appropriate where such a significant sum is in dispute it is difficult to see when it would ever be. As a result the Appellant has been placed at a disadvantage. HMRC's case goes beyond matters within the Appellant's direct knowledge and relies on circumstantial evidence, yet the Appellant has been restricted in its disclosure to matters of direct relevance to the Appellant's state of mind. The appeal should be allowed by reason of HMRC's inadequate disclosure.

(iv) Validity of the penalty

214. Section 61 VATA 1994 requires that a notice be served on Waterfire and in the absence of such the purported notice is defective and void.

(v) Terminology

215. Firstly it must be decided whether the Appellant knew of the underlying fraud and secondly it must be determined whether he benefitted from it and, if so, to what extent. While knowledge may in some circumstances indicate a level of participation, in other cases it may not and as such it is not open to the Tribunal to adopt a blanket assumption.

(vi) Authorities

216. HMRC's case in *Optigen* was rejected by Advocate General Poiares Maduro in an opinion dated 16 February 2005 which suggested that it was not the case that there was clear authority to permit the refusal of input tax in cases of fraud (at [42]):

"If the Court were to accept the interpretation advocated by the United Kingdom, that would give rise to considerable uncertainty concerning the application of the Sixth Directive. Such an interpretation would mean that, if traders wanted to be sure at the time of a transaction that they were incurring rights and obligations under the VAT system, they would have to predict whether the specific goods which were the subject of the transaction would at some point fall back into the hands of a trader who had already played a part in the supply chain. If that were to be the case, they would also need to know about any subsequent 'disappearance' on the part of that trader. (35) Meanwhile, account should be taken of the possibility that one and the same consignment may contain goods that are used in the fraud and goods that are not - only the latter would be subject to VAT, if the United Kingdom's argument were accepted. This interpretation of the notion of 'economic activity' runs counter to the principle of legal certainty, which is a general principle of Community law that must be observed by Member States when implementing the Sixth Directive. (36) As Optigen, Fulcrum and Bond House moreover correctly submit, the United Kingdom's approach might act as a deterrent to legitimate trade."

217. The decision in *Optigen* was not given until 12 January 2006. On 14 March 2006 Advocate General Ruiz-Jarabo Colomer gave his opinion in *Kittel* (at [41] – [44]):

"…an activity does not become financially unlawful because the person exercising it knows that the businessman with whom he is trading has an unlawful purpose, since that transaction, subject to VAT, gives rise to the subsequent right to deduct.

The neutrality which governs this tax precludes the exclusion from the scope of its rules of business transactions which are part of its subject-matter. The judgment in Optigen and Others reiterated that the right to deduct is exercised regardless of whether the VAT on other previous or subsequent transactions has been paid or not (paragraph 54).

The conduct of the 'disloyal' taxpayer, who does not inform the Treasury of the stratagem, has various consequences (16) but it never causes the setting aside of a fundamental rule of the VAT scheme, which is that at each stage of the production or distribution process the tax is levied and the VAT paid at the previous stages is deducted."

218. Thus when Waterfire submitted its return on 15 May 2006 the most recent pronouncement on the area was that of Advocate General Ruiz-Jarabo Colomer. It cannot therefore be correct to state that the law at that time was sufficiently clear that a penalty could be imposed on a knowing purchaser.

219. The decision of the CJEU in *Kittel* which was given on 6 July 2006 departed from that of Advocate General Ruiz-Jarabo Colomer. The Appellant could not have been expected to know the position under EU law at the date of the relevant claim.

220. As regards UK persons such as the Appellant or Waterfire the relevant legislation is contained in VATA 1994. In order to rely on *Kittel* jurisprudence it is necessary to construe the right to reclaim input tax in section 26 VATA 1994 as limited in circumstances where a supply is connected with fraud. However the clear wording of section 26 does not suggest that such a limitation can be read in.

221. One of the grounds of challenge in *Mobilx* was that the principles enunciated by the CJEU in *Kittel* could not be applied as part of UK domestic law without specific legislation. This was rejected by the Court of Appeal at [49]:

"*It is the obligation of domestic courts to interpret the VATA 1994 in the light of the wording and purpose of the Sixth Directive as understood by the ECJ (Marleasing SA 1990 ECR 1-4135 [1992] 1 CMLR 305) (see, for a full discussion of this obligation, the judgment of Arden LJ in Revenue and Customs Commissioners v IDT Card Services Ireland Limited [2006] EWCA Civ 29 [2006] STC 1252, §§ 69-83). Arden LJ acknowledges, as the ECJ has itself recognised, that the application of the Marleasing principle may result in the imposition of a civil liability where such a liability would not otherwise have been imposed under domestic law (see IDT § 111). The denial of the right to deduct in this case stems from principles which apply throughout the Community in respect of what is said to be reliance on Community law for fraudulent ends. It can be no objection to that approach to Community law that in purely domestic circumstances a trader might not be regarded as an accessory to fraud. In a sense, the dichotomy between domestic and Community law, in the circumstances of these appeals, is false. In relation to the right to deduct input tax, Community and domestic law are one and the same.*"

222. The Appellant submitted that the conforming interpretation adopted by the Court of Appeal in *Mobilx* cannot extend to a penalty which is classified as criminal for the purposes of the ECHR and EU Charter. Nor is it a justification for the attempted extension of the penalty regime by reference to case law that the penalty under Section 61 VATA 1994 is classified as civil under UK law; it is clearly criminal for the purposes of the ECHR and EU Charter.

<u>(vii) Reliance on the ECHR and EU Charter</u>

223. Article 7 of the ECHR provides as follows:

"*No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the time when it was committed. Nor shall a heavier penalty be imposed than the one that was applicable at the time the criminal offence was committed.*"

224. Article 7 also requires that criminal law should be clearly set out and understandable and should not be widely construed to the disadvantage of the person being penalised.

225. Article 49 of the EU Charter is in similar terms and expressly includes an obligation that penalties must not be disproportionate:

"No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national law or international law at the time when it was committed. Nor shall a heavier penalty be imposed than that which was applicable at the time the criminal offence was committed. If, subsequent to the commission of a criminal offence, the law provides for a lighter penalty, that penalty shall be applicable.

This Article shall not prejudice the trial and punishment of any person for any act or omission which, at the time when it was committed, was criminal according to the general principles recognised by the community of nations.

The severity of penalties must not be disproportionate to the criminal offence."

226. The only basis for HMRC's case, that Waterfire evaded tax by making a claim for input tax to which it was not entitled, is *Mobilx*. It is overly simplistic to state that there can be no retroactive penalisation because section 61 VATA 1994 was in force at the relevant time. That section does not apply in a vacuum and relies on a denial of input tax based on more recent case law.

227. The *Kittel* decision represented a novel development of the law on the interpretation of the Sixth Directive as recognised by Moses J in *Mobilx* at [41]:

"In Kittel after § 55 the Court developed its established principles in relation to fraudulent evasion. It extended the principle, that the objective criteria are not met where tax is evaded, beyond evasion by the taxable person himself to the position of those who knew or should have known that by their purchase they were taking part in a transaction connected with fraudulent evasion of VAT…"

228. It expanded upon the decision in *Optigen* and provided a new ground upon which a right of deduction could be refused. The impact of those decisions as a matter of UK law was only established in *Mobilx*. Any penalty based on this case law cannot, consistently with Article 7 of the ECHR, relate to activities predating the Court of Appeal's decision.

229. The Appellant submitted that the imposition of a penalty in the current circumstances involves a clear breach of Article 7 of the ECHR and Article 49 of the EU Charter. If the Tribunal has any doubt on this issue the matter should be referred to the CJEU.

230. Article 50 of the EU Charter provides:

"*No one shall be liable to be tried or punished again in criminal proceedings for an offence for which he or she has already been finally acquitted or convicted within the Union in accordance with the law."*

231. The penalty imposed on Waterfire breached this provision as the refusal to a right to deduct was also a penalty, as recognised by the CJEU in a number of cases such as *Mahageban*:

"By contrast, it is incompatible with the rules governing the right to deduct under that directive, as noted in paragraphs 37 to 40 of the present judgment, to impose a penalty, in the form of refusing that right to a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud committed by the supplier, or that another transaction forming part of the chain of supply prior or subsequent to that transaction carried out by the taxable person was vitiated by VAT fraud (see, to that effect, Optigen and Others, paragraphs 52 and 55, and Kittel and Recolta Recycling, paragraphs 45, 46 and 60)."

232. It is not open to the Tribunal to prefer the approach of the Court of Appeal in *Mobilx* in interpreting the CJEU's case law to that of the CJEU. The Tribunal must either accept that the denial of input tax is a penalty and a breach of Article 50 or make a reference to the CJEU.

(viii) The penalty is disproportionate

233. Article 49 of the EU Charter imposes a directly enforceable right that a penalty must not be disproportionate to the offence. The penalty imposed on the Appellant is manifestly disproportionate to the conduct complained of and vastly exceeds the amount by which Waterfire could have profited from the transaction or the amount of VAT jeopardised by Waterfire having made a claim for input tax on the supplies.

(ix) Construction of Sections 60 and 61 VATA 1994

234. In order for section 60 VATA 1994 to apply, tax must be evaded. It was submitted on behalf of the Appellant that at the very least the use of the word "evading" imports a requirement of dishonesty in the attempt to obtain an undeserved VAT credit. Where, it was submitted, as here there was a genuine and reasonable belief in the entitlement to the VAT credit there cannot have been VAT evasion.

235. The Appellant submitted that the definition must be even more narrowly construed so that it cannot include the claiming of input tax that was genuinely incurred and which there was a prima facie right to claim under section 26 VATA 1994. The following definition from *R v Dealy* [1995] STC 215 has been applied by the Tribunal in a number of cases involving section 60 and 61 VATA 1994:

"We look next at the judge's direction to the jury on law:

'Well, what does "evasion" mean? Evasion is an English word that means to get out of something. If you evade something, you get out of its way, you dodge it, and that, of course, is what this case is about. Was Mr. Dealy trying to dodge paying the VAT that his company, the limited company, Yorkshire Clothing Company Limited, owed to the Customs and Excise.

Well, what that word means, basically, is dishonesty, and here we come to it. What is dishonesty in English Law? It is a common English word and it carries its ordinary English meaning. The twelve of you must, first, look at what he did. You must decide for yourselves, first of all, whether ordinary, right-thinking people would describe what Mr. Dealy did as dishonest. If the answer is "No, ordinary, sensible people

would not regard what he did as being dishonest" then he is not guilty. However, if you decide that ordinary, reasonable people would see his conduct as dishonest, you must then go on to decide what he thought about it. If you come to the conclusion that Mr. Dealy might have thought, quite honestly, that he had a perfect right to do as he did, and that no one would regard it as dishonest, then he is not guilty. If he was convinced, throughout, that he was doing the right thing, and that other people would agree with him, that is not dishonesty.'"

236. The term "evasion" even as expanded by section 60 (2) VATA 1994 must be more limited in scope and read consistently with the basis meaning set out in *Dealy.* As such, although it covers a claim to input tax which is made knowing that there is no basis for such claim, it cannot apply to a claim which is made in the genuine and honest belief that the person is entitled to the tax. The extension of the meaning in subsection (2) is required because a claim for input tax which is falsely made would not fall within the natural meaning of "evasion". Evasion suggests not paying tax which is due i.e. "dodging a liability".

237. The Appellant submitted that it is crucial to identify the relevant evasion by Waterfire for the purposes of Section 60 VATA 1994 and "not to confuse it with the wider evasion which is going on which is in fact largely irrelevant to the operation of section 60 VATA 1994". It cannot be the case that Waterfire entered into the transactions for the purpose of obtaining a VAT credit; it entered into those transactions to make a profit.

(x) Dishonesty

238. HMRC allege dishonesty that does not directly relate to the conduct for which the Appellant is being penalised. The Appellant is being penalised because, HMRC allege, Waterfire was acting dishonestly in claiming input tax that was not due to it. Collateral dishonesty, such as covering up someone else's fraud, even if found to exist, is irrelevant to the operation of section 60 VATA 1994.

239. The Appellant invited the Tribunal to adopt the approach of Judge Sinfield in *Ermis v HM Revenue and Customs* [2014] UKFTT 367 (TC) at [12] and [13]:

"The test for dishonesty in civil penalty cases is the same as that in criminal cases. The test was established by Lord Lane in R v Ghosh [1982] 2 QB 1053. In Ghosh, Lord Lane held that the test was a two-stage test: the first stage an objective test and the second stage a subjective test. Lord Lane stated at page 1064:

"In determining whether the prosecution has proved that the defendant was acting dishonestly, a jury must first of all decide whether according to the ordinary standards of reasonable and honest people what was done was dishonest. If it was not dishonest by those standards, this is the end of the matter and the prosecution fails.

If it was dishonest by those standards, then the jury must consider whether the defendant himself must have realised that what he was doing was by those standards dishonest. In most cases, where the actions are obviously dishonest by ordinary standards, there will be no doubt about it. It will be obvious that the defendant himself knew that he was acting dishonestly."

(xi) Amount of the penalty

240. HMRC are required to prove that there was an amount falsely claimed by way of credit for input tax. However there was nothing in the VAT return or accompanying leaflets which indicated any limitation on the right to reclaim VAT. It was a requirement that VAT be incurred but no limitation beyond that. In those circumstance a claim to input tax genuinely incurred cannot properly be regarded as false unless the term "false" is given an untenably wide interpretation which is at odds with *R v Rimmington* [2005] UKHL 63 per Lord Bingham at [33]:

"There are two guiding principles: no one should be punished under a law unless it is sufficiently clear and certain to enable him to know what conduct is forbidden before he does it; and no one should be punished for any act which was not clearly and ascertainably punishable when the act was done. If the ambit of a common law offence is to be enlarged, it "must be done step by step on a case by case basis and not with one large leap": R v Clark (Mark) [2003] EWCA Crim 991, [2003] 2 Cr App R 363, para 13."

(xi) Refusal of right to deduct

241. The Appellant submitted that the CJEU authorities do not support the proposition that no right to deduct arises where there is a connection with fraud; rather there is a prima facie right to deduct, which can be refused. Therefore, it cannot be said that in making a claim that was liable to be refused, Waterfire made a false claim; a false claim is one that has no legitimate basis.

242. It is not accepted that the evidence shows that the transactions took place in the context of a wider scheme to defraud the Revenue. However even if this were the case, it would not be sufficient to deny Waterfire the right to recover VAT prior to *Kittel* and, even after *Kittel*, it would not deny such a right *ab initio* so as to make the claim false or dishonest.

243. Bearing in mind the objective nature of VAT, to assess the objective character of a transaction one must look to its physical attributes and economic effect. Why any of the parties entered into the transactions or their intentions in so doing is irrelevant. From the VAT perspective it means little to say that the transactions entered into by Waterfire were fraudulent in nature, especially as the principle of fiscal neutrality prevents any general distinction between lawful and unlawful transactions (see *Kittel* at [50]). If the transactions gave rise to taxable supplies then the taxable person would not evade tax. As Waterfire incurred input tax for the purpose of itself making taxable supplies, then the input tax would prima facie be deductible, notwithstanding any supposed wider fraudulent intent behind the transactions.

244. The Appellant accepted that a taxpayer cannot rely on any right under the VAT Directive for fraudulent ends because *"preventing tax evasion, avoidance and abuse is an objective recognised and encouraged"* by the Directive and *"Community law cannot be relied on for abusive or fraudulent ends"* (*Kittel* at [54]). However it submitted that pre-*Kittel* the circumstances in which a taxpayer could be denied his right to deduct for fraud related reasons were limited to the situation whereby the exercise of the right resulted in itself in the fraudulent evasion of VAT. The four situations in which this could occur are:

- A supply is made, output tax is payable but not declared;
- No output tax is payable but the taxpayer charges it and keeps it;
- No VAT is incurred but the taxpayer deducts an amount purporting to be input tax; or
- VAT is incurred which is not deductible input tax but the taxpayer treats it as such.

245. Where the objective criteria for engaging the right to deduct are satisfied, the right to deduct crystallises and even in circumstances where fraud is established, and it becomes permissible for a tax authority to refuse the taxpayer his right to deduct, the ECJ does not refer to the taxpayer ceasing to have the right, or the right ceasing to exist. Rather, at [55] of *Kittel*:

"*Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 Rompelman [1985] ECR 655, paragraph 24; Case C-110/94 INZO [1996] ECR I-857, paragraph 24; and Gabalfrisa, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see Fini H, paragraph 34).*"

246. This suggests that the right remains capable of being exercised even in cases of fraud and remains in effect until such time as either the tax authorities or a Court refuses it. As such, even if Kittel had retrospective effect, Waterfire would still have been entitled to deduct the VAT in question at the relevant time.

247. The Appellant submitted, relying on *Halifax and Others* [2006] EUECJ C-255/02 (21 February 2006) in support, that abuse of right cannot be relied upon to justify the imposition of a penalty:

"It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of that finding, which rendered undue all or part of the deductions of input VAT…"

(xii) Submissions on the evidence

248. In essence, the Appellant submitted that the witnesses called by HMRC to give evidence were unreliable, institutionally biased and lacking in the necessary expertise or commercial acumen to give evidence. All of the evidence of the witnesses was based on analysis and interpretation of work by others who were not called to give evidence. It was submitted that when the evidence is unravelled, all of the witnesses had effectively shared the same information, however HMRC had chosen to call numerous witnesses rather than just one in an attempt to make the evidence seem more compelling. None of the witnesses for HMRC had ever worked in the mobile phone industry and as such they were not suitably placed to make assumptions as to what would constitute "commercial transactions."

249. The Appellant highlighted Mr Lyon's evidence that much of the information he had obtained in this case came from Mr Mody. It was submitted that Mr Lyon's evidence was contradictory in that he initially stated that Mr Mody played a significant part in his decision making process yet he later went on to say that he and Mr Mody had not discussed his decision making process. Furthermore Mr Lyon was unable to recall the part played by the various documents he had reviewed in his decision making or what documents he had considered in producing reports forming the background to the decision. Mr Lyon did not consider whether or not a civil evasion penalty could be imposed, only whether there had been dishonest conduct. He did not consider whether completion of the repayment claim had been dishonest.

250. The Appellant did not accept that Mr Stone had the expertise to explain how MTIC fraud worked and the fact that he gave his opinion on a number of matters was highlighted by the Appellant to demonstrate his lack of impartiality. The Appellant relied on *Butkevicius v Lithuania* (Application number 48297/99) which held that:

"*The Court recalls that the presumption of innocence enshrined in Article 6 § 2 of the Convention is one of the elements of a fair criminal trial guaranteed by Article 6 § 1. It will be violated if a statement of a public official concerning a person charged with a criminal offence reflects an opinion that he is guilty before he has been proved so according to law. It suffices, even in the absence of any formal finding, that there is some reasoning to suggest that the official regards the accused as guilty. Moreover, the presumption of innocence may be infringed not only by a judge or court but also by other public authorities (Daktaras v. Lithuania, no. 42095/98, §§ 41-42, ECHR 2000-X). In the above mentioned Daktaras case the Court emphasised the importance of the choice of words by public officials in their statements before a person has been tried and found guilty of an offence. Nevertheless, whether a statement of a public official is in breach of the presumption of innocence must be determined in the context of the particular circumstances in which the impugned statement was made (ibid.).*"

251. The Appellant submitted that as Mr Stone is a public official and the Appellant has been charged with a criminal offence for Article 6 purposes, Mr Stone's statement was a clear violation of the presumption of innocence. The evidence of Mr Stone was also affected by a lack of disclosure that undermined the Appellant's ability to effectively cross-examine the witness.

252. It was submitted that Ms Sharkey's analysis of Waterfire's transaction chains was biased as demonstrated by her statement which was made "in support" of HMRC's case. Furthermore Ms Sharkey's analysis was fundamentally flawed. Although the Appellant accepted that there was circularity of funds in Waterfire's transaction chains the method used by Ms Sharkey is not accepted. Lengthy submissions were made by the Appellant as to Ms Sharkey's qualifications which can be summarised as follows: Ms Sharkey has no relevant qualifications or experience to carry out the analysis which required a forensic accountant. Ms Sharkey's evidence should therefore be treated with caution and little weight given to it.

253. Additionally Ms Sharkey's sampling method was flawed which renders the conclusions unsafe; the method was unscientific and biased towards determining that Waterfire was always involved in circular transactions. Ms Sharkey could not say what percentage of acquisition transactions she had sampled nor had she considered the correct statistical method to apply in order to achieve a fair sample. Finally, Ms Sharkey reached conclusions in which she gave opinion evidence. In cross-

examination Ms Sharkey accepted that her conclusions were limited in so far as they applied specifically to Waterfire, for instance she agreed that it had not shared an IP address with other traders in the chains.

254. Mr Milroy accepted that his knowledge and experience related to criminal matters and his involvement in the Appellant's case was limited because the case was rejected by his team as unsuitable for criminal proceedings. It was submitted that Mr Milroy's evidence was irrelevant to the issues to be determined, particularly as he accepted that he had not considered whether a section 60 or 61 penalty could be validly imposed.

255. Mr Mody accepted that he had no direct experience of the commercial mobile phone market and that his experience came from reviewing cases that had been identified by others as suspicious.

256. Mr Humphries accepted he had never worked in a commercial context or in the mobile phone market.

257. Mr Fletcher, who purported to give evidence as an expert, accepted that he had not considered how the operation of a market deeply affected by fraud might affect his analysis and agreed that his analysis was flawed as a result. There was also a lack of disclosure in relation to his evidence; this undermined the Appellant's ability to challenge the evidence.

258. Taking into account the general bias displayed by HMRC's witnesses to traders in the mobile phone industry the Tribunal should attach little or no weight to their evidence.

259. The Tribunal must also concede a lack of expertise in data analysis and awareness of normal commercial practices and therefore without assistance of expert evidence cannot reach conclusions on the evidence.

(xiii) Right to silence

260. In reliance on Article 6 ECHR the Appellant need not give evidence and need not do anything that is likely to incriminate him.

261. It is accepted by the Appellant that by maintaining his right to silence, the issue arises as to whether the Tribunal can or should draw adverse inferences. The Appellant does not contend that a "great deal of weight" should be given to the Appellant's witness statement in the absence of its contents being confirmed on oath and tested in cross-examination, although the Tribunal was invited to note that the statement is consistent with earlier statements made by him. However the Appellant submitted that even if little weight is attached to the statement, HMRC still fail to prove their case.

262. As to the issue of adverse inferences the Appellant, relying on Proudman J in *HMRC v Sunico* [2013] EWHC 941 (Ch), submitted that the Tribunal should not draw any such inferences for the following reasons:

> (a) To do so would infringe the Appellant's rights under Article 6 of the ECHR;

(b) Even if adverse inferences are drawn, HMRC have not made out their case;

(c) Any adverse inferences to be drawn do not support HMRC's contentions;

(d) Little weight should be attached to any adverse inferences drawn because HMRC have adduced little or no evidence upon which the Appellant can comment.

263. The Appellant submitted that the standard in civil proceedings is not relevant to the standard to be applied in this appeal due to the criminal nature of the penalty and the engagement of the Appellant's Article 6 rights.

264. The Appellant drew the Tribunal's attention to *Adetoro v UK* [2010] ECHR 46834/06 at [47] – [49]:

"*The Court recalls at the outset that the right to silence is not an absolute right (see John Murray, cited above, § 47; Condron, cited above, § 56; and Beckles, cited above, § 57). The fact that a trial judge leaves a jury with the option of drawing an adverse inference from an accused's silence during police interview cannot of itself be considered incompatible with the requirements of a fair trial. However, as the Court has previously emphasised, the right to silence lies at the heart of the notion of a fair procedure under Article 6 and particular caution is required before a domestic court can invoke an accused's silence against him (see Beckles, cited above, § 58; and Condron, cited above, § 56).*

It would be incompatible with the right to silence to base a conviction solely or mainly on the accused's silence or on a refusal to answer questions. However, it is obvious that the right cannot and should not prevent that the accused's silence, in situations which clearly call for an explanation from him, be taken into account in assessing the persuasiveness of the evidence adduced by the prosecution (see Condron, cited above, § 56; and Beckles, cited above, § 58).

Whether the drawing of adverse inferences from an accused's silence infringes Article 6 is a matter to be determined in the light of all the circumstances of the case, having regard to the situations where inferences may be drawn, the weight attached to them by the national courts in their assessment of the evidence and the degree of compulsion inherent in the situation (John Murray, cited above, § 47; and Condron, cited above, § 56). In practice, adequate safeguards must be in place to ensure that any adverse inferences do not go beyond what is permitted under Article 6 § 1 of the Convention. Of particular relevance are the terms of the trial judge's direction to the jury on the issue of adverse inferences (see Beckles, cited above, § 59)."

265. In summary, it was submitted that the Tribunal should apply the following criteria:

(a) The Appellant's silence can only be invoked against him where particular caution has been applied;

(b) Safeguards must be in place to protect the right to a fair trial;

(c) A decision of the Tribunal in HMRC's favour cannot be based mainly on one or more adverse inferences drawn from the Appellant's

silence as HMRC have failed to show that the Appellant had the requisite knowledge, or should have had the requisite knowledge;

(d) There is no evidence in this case which requires an explanation from the Appellant;

(e) The Tribunal must consider the weight to be given to any such inference.

266. As regards infringement of the Appellant's Article 6 rights by drawing adverse inferences, the Appellant submitted that "in cases that are also criminal under national law the identification of appropriate safeguards is more straightforward than in this case" citing police cautions and directions to a jury by way of example. It was submitted that the normal criminal protections do not apply in this case and there are no similar safeguards in the procedural law governing the First-tier Tribunal.

267. The Appellant submitted that prior to accepting the Appellant's decision not to give evidence the Tribunal should have considered what safeguards needed to be put in place to protect his Article 6 rights. The Tribunal should also have heard submissions on the point in advance in order to advise the Appellant how it proposed to deal with his decision not to give evidence.

268. The Appellant submitted that Waterfire's transaction chains are "nothing more than a prejudicial sideshow" and have no bearing on the central issue as to whether the claim itself was dishonest. In those circumstances there was no need for the Appellant to give evidence.

269. HMRC's evidence is almost wholly aimed at establishing that there was a general scheme of fraud around Waterfire's transactions. There is no compelling evidence in relation to the central question, namely was Waterfire dishonest in making its claim for input tax.

270. HMRC's evidence is weak and circumstantial and the Tribunal should reject HMRC's invitation to draw unspecified adverse inferences. Furthermore HMRC's case as to the Appellant's dishonesty is ill defined and the Appellant was therefore naturally reluctant to put himself in an unfamiliar and potentially damaging situation.

HMRC's submissions

271. HMRC submitted that the Appellant had misunderstood the basis for the decision under appeal; this was not that Waterfire was denied its entitlement to claim input tax credit in respect of transactions conducted in period 04/06 in accordance with *Kittel* principles. The basis of the decision was the fulfilment of the statutory requirements of section 61(1) VATA 1994:

- The transactions in respect of which Waterfire claimed (and was denied) an input tax credit in VAT period 04/06 were connected with the fraudulent evasion of VAT;

- By entering into those transactions which it knew (through the Appellant, Mr Tahir or either of them) to be connected with fraud and/or making VAT returns on the basis of those transactions, Waterfire had done an act/acts for the purpose of evading VAT;

- Waterfire, through the Appellant, knew that the transactions it entered into were connected with fraud and that the VAT returns submitted were based upon transactions so connected, such that Waterfire's conduct was dishonest;

- Waterfire was liable to a penalty under section 60 of VATA 1994 in respect of the VAT sought to be evaded, namely the amount of the input tax credit claimed by it in its VAT return for period 04/06 (£6,972,184);

- The conduct giving rise to Waterfire's liability to a penalty was in whole or in part attributable to the Appellant and Mr Tahir or either of them.

272. HMRC submitted that the penalty does not rely upon an interaction of the statutory penalties and MTIC case law; rather it relies on the Tribunal being satisfied to the requisite standard that the statutory criteria set out in sections 60 and 61 VATA 1994 have been fulfilled.

273. The provisions of Section 60(2) are not restricted as suggested by the Appellant. The observations of the Court of Appeal in *Dealy*, relied upon by the Appellant, are of limited assistance for the present purposes as in *Dealy* the Court was asked to provide a definition of the word *"evasion"* as it appeared in Section 39 of VATA 1994 in a particular factual context. The question asked of the Court of Appeal was: *"Does the word "evasion" in section 39(1) of the Value Added Tax Act 1994 mean (a) a deliberate non-payment when a payment is due, or (b) a deliberate non-payment when a payment is due with intent to make permanent default in whole or in part of that existing liability."* The Court was not asked to consider the term in the context of a taxpayer who rendered a VAT return based upon transactions he knew to be fraudulent.

274. Evading or seeking to evade VAT can include obtaining or seeking to obtain a VAT credit. HMRC submitted that for these purposes a VAT credit refers to the aggregate of the amount falsely claimed by way of credit for input tax and the amount by which output tax was falsely understated. It must be the case that a taxpayer's attempt to obtain input tax credit in respect of transactions which were connected with fraud and which it knew to be connected with fraud is an act for the purpose of evading VAT and amounts to a false claim for input tax credit. Such an interpretation is consistent with the statutory criteria set out in Section 60 VATA 1994. It cannot sensibly be contended that input tax credit claimed in such circumstances was not falsely claimed and was "properly due".

275. HMRC submitted that the description of the refusal of the right to deduct as a penalty in *Mahagében* does not accord with the description applied earlier in the same authority, nor with descriptions applied elsewhere. The refusal of the right to deduct is, properly considered, a loss of a right or benefit. In so submitting, HMRC relied on the following authorities:

> (a) At [64] of *Mobilx* Moses J observed: *"on my interpretation of the principle in Kittel, there is no question of penalising the traders..."* and at [65]: *"The Kittel principle is not concerned with penalty...the principle is concerned with identifying the objective criteria which must be met before the right to deduct arises. Those criteria are not met, as I have emphasised, where the trader is regarded as a participant in the fraud. No penalty is imposed; his transaction falls outwith the scope of VAT and,*

accordingly, he is denied the right to deduct input tax by reason of his participation."

(b) At [45] of *Mahagében* the CJEU described the right to deduct as a benefit: *"…a taxable person can be refused the benefit of the right to deduct only on the basis of the case-law resulting from paragraphs 56 to 61 of Kittel and Ricolta Recycling, according to which it must be established on the basis of objective factors, that the taxable person to whom were supplied the goods or services which served as the basis on which to substantiate the right to deduct, knew, or ought to have known, that that transaction was connected with fraud previously committed by the supplier or another trader at an earlier stage in the transaction."*

276. HMRC submitted that the use of the term "penalty" at [47] of *Mahagében* may be termed a misnomer in those circumstances.

277. It has always been open to the tax authorities to claim repayment of the deducted sums retroactively. Similarly the tax authorities have – pre-*Kittel* – been permitted to refuse to allow the right to deduct where it established that that right was relied on for fraudulent ends. HMRC submitted that in *Kittel,* the CJEU developed an already long-established principle, namely that the objective criteria for identifying supply of goods or services and economic activity are not met where tax is evaded or sought to be evaded.

278. The development in *Kittel* related only to the issue of constructive knowledge of the taxable person with regard to transactions other than his own. In *Optigen* the CJEU rejected the contention that the transactions of innocent parties could not be regarded as economic activities if they formed part of a series of transactions with a fraudulent objective. The CJEU distinguished between transactions into which the innocent parties had entered from those transactions "vitiated by fraud". It was the fact that the transactions of the unwitting traders in *Optigen* met the objective criteria which formed the basis of the Court's rejection of the Commissioners' attempt to deny repayment. *Kittel* took a similar approach but went on to consider the converse proposition; namely whether the objective criteria are met where the taxable person does not know or should have known that the transaction was connected with fraud. In *Halifax* (at [59]) the Court emphasised that the objective criteria are not satisfied where tax is evaded.

"It is true that those criteria are not satisfied where tax is evaded, for example by means of untruthful tax returns or the issue of improper invoices. The fact nevertheless remains that the question whether a given transaction is carried out for the sole purpose of obtaining a tax advantage is entirely irrelevant in determining whether it constitutes a supply of goods or services and an economic activity."

279. HMRC highlighted *Mobilx* in which Moses J held that the principles set out in *Kittel* could be applied as part of UK domestic law without the introduction of further UK legislation. The Appellant's reference this "conforming interpretation" being limited to civil penalties misunderstands the nature of and basis for the penalty; the penalty imposed upon the Appellant is a creature of statute and its imposition does not depend upon proof that Waterfire's claim to input tax credit was, or should have been, disallowed.

280. HMRC agreed that having been made subject to a civil penalty under section 60(1) VATA 1994 the Appellant is entitled to rely upon the rights provided for in Articles 6 and 7 of the ECHR. It was noted by HMRC that the concept of a "criminal charge" under Article 6 has an autonomous Convention meaning. Three criteria are applied by the Strasbourg court to determine whether a criminal charge has been imposed: the classification of the proceedings in domestic law; the nature of the offence; and the nature and degree of severity of the penalty that the person concerned risked incurring. The requirements are not treated as a three-stage process but as factors to be weighed together in deciding whether the relevant measure should be treated as criminal. HMRC also referred us to *Han and Yau v HMCE* [2001] 1 WLR 2253 in which the Court of Appeal held that a penalty imposed pursuant to section 60 of VATA 1994 is a "criminal charge" for the purposes of Article 6 of the ECHR.

281. In response to the Appellant's submissions regarding the Appellant's right not to be punished twice HMRC reiterated that the refusal of the right to deduct cannot properly be regarded as a penalty such that any penalty subsequently imposed upon Waterfire pursuant to Section 60 VATA 1994 cannot be regarded as a "second penalty" for the same conduct.

282. HMRC's submissions on the evidence can be summarised as follows; direct evidence of the Appellant's participation in, or knowledge of, fraud is very rarely, if ever, going to be available irrespective of which court or tribunal the allegation is brought before. However, in all forums the tribunal of fact is permitted to infer from the facts proved other facts necessary to establish guilt, participation in fraud, intention, dishonesty or any other proposition required to prove a case. The combination of individual factors may together give rise to a clear inference that an Appellant acted dishonestly or did an act for the purpose of evading VAT.

283. HMRC relied on *Megtian* at [21] – [25] in support of its contention that the Tribunal may rely upon circumstantial evidence to make a finding of dishonest knowledge:

"It was therefore necessary for HMRC to establish that @tomic, as such a contra-trader, knew that transactions in which it participated at the foot of dirty chains were connected with fraud...

In my judgment the primary facts found by the Tribunal relevant to @tomic's knowledge were, in the aggregate, sufficient to permit the Tribunal, if it thought fit, to make a finding of dishonest knowledge on the part of @tomic. It is in this context important for an appeal court to have regard to the need to appraise the overall effect of primary facts, rather than merely their individual effect viewed separately. As Lewison J put it in Arif v. Revenue and Customs Commissioners [2006] EWHC 1262 (Ch) at paragraph 22:

"There is one other general comment that is appropriate at this stage. It relates to the evaluation of circumstantial evidence. Pollock CB famously likened circumstantial evidence to strands in a cord, one of which might be quite insufficient to sustain the weight, but three stranded together might be quite sufficient (R v Exall (1966) 4 F & F 922). Thus there can be no valid criticism of a tribunal which considers that one piece of evidence, while raising a suspicion, is not enough on its own to find dishonesty; but that several such pieces of evidence, taken cumulatively, lead to that conclusion."

Furthermore, although evidence that @tomic made a claim for input tax during the relevant period was of course material to the Tribunal's decision whether to draw an inference that it had dishonest knowledge, it comes nowhere near being sufficient to serve as the basis for a conclusion that the primary facts relied upon were incapable in the aggregate of justifying such an inference, still less that the inference was contrary to all the evidence. No error of law is disclosed by the fact that the Tribunal did not in expressing its conclusions about @tomic's state of knowledge, refer expressly to that evidence."

284. HMRC submitted that the Appellant had acted dishonestly on a number of occasions and over a lengthy period of time; he has stolen from Waterfire, allowed incorrect accounts to be filed and dishonestly failed to declare or account for tax. No explanation has been provided by the Appellant for the numerous features and anomalies in trading which together demonstrate dishonesty on his part.

285. On the issues of right to silence and adverse inferences HMRC highlighted that those representing the Appellant notified the Tribunal on 25 June 2014 that the Appellant would not be called to give evidence. HMRC agreed at the time that the Appellant's witness statements should remain in evidence but submitted that very little weight should be attached to the contents, as the evidence had not been tested in cross-examination. HMRC submitted:

(a) Although Mr Butt attended the hearing he did not give evidence;

(b) Mr Butt did not confirm on oath that the contents of the statement were true to the best of his knowledge and belief;

(c) The contents of the statements were limited;

(d) Mr Butt did not give evidence under oath in connection with the matters raised in this appeal;

(e) Mr Butt's evidence was not tested by cross-examination.

286. In those circumstances HMRC submitted that minimal weight should be attached to the statements.

287. As to adverse inferences, HMRC referred us to *The Commissioners for HM Revenue and Customs Commissioners v Sunico A/S* [2013] EWHC 941 which cited with approval the principles set out by Broke LJ in *Wisniewski v Central Manchester Health Authority* [1998] PIQR 324:

"*…the familiar four principles summarised by Brooke LJ in Wisniewski v Central Manchester Health Authority ([1998] PIQR 324, at p 340:*

"(1) In certain circumstances a court may be entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action.

(2) If a court is willing to draw such inferences, they may go to strengthen the evidence adduced on that issue by the other party or to weaken the evidence, if any, adduced by the party who might reasonably have been expected to call the witness.

(3) There must, however, have been some evidence, however weak, adduced by the former on the matter in question before the court is entitled to draw the desired inference: in other words, there must be a case to answer on that issue.

(4) If the reason for the witness's absence or silence satisfies the court then no such adverse inference may be drawn. If, on the other hand, there is some credible explanation given, even if it is not wholly satisfactory, the potentially detrimental effect of his/her absence or silence may be reduced or nullified."…

What is true, however, is that the question of whether there is a case to answer does depend on the individual case and the allegations in question. If the court is to draw adverse inferences, they cannot simply be of a general nature; they must be specific inferences in relation to specific pleaded issues. I am mindful that this is a case where very serious allegations of fraud have been made against the Defendants and, whilst this does not affect the standard of proof, it does have some bearing on my approach to the evidence and the burden on HMRC to prove its claim."

288. In applying the principles enunciated in *Sunico,* HMRC made the following submissions:

(a) HMRC have shown a prima facie case to answer that Waterfire, through the Appellant, knew that the transactions it entered into were connected with fraud and that the VAT returns submitted were based upon transactions so connected, such that Waterfire's conduct was dishonest;

(b) HMRC's prima facie case is supported by evidence;

(c) The Appellant, as one of the two directors of Waterfire, was a witness who might properly be expected to have material evidence to give on matters in issue in these proceedings;

(d) No explanation was advanced by or on behalf of the Appellant to explain his failure to give evidence, such that there is no basis for the Tribunal to reduce the potentially detrimental effect of his silence;

(e) The Tribunal is entitled to, and should properly, draw inferences from the failure of the Appellant to give evidence in answer to HMRC's prima facie case;

(f) Those adverse inferences go to strengthen the evidence adduced by HMRC on the matters in issue in these proceedings.

289. HMRC submitted although the penalty is a *"criminal charge"* for the purposes of Article 6 of the ECHR, it does not follow from that determination in *Han and Yau* that the rules applicable in a criminal court apply to proceedings before a Tribunal. Furthermore the right to silence is not an absolute right. In *Murray (John) V UK* (1996) 22 EHRR 29 the European Court of Human Rights stated:

"Whether the drawing of adverse inferences from an accused's silence infringes Article 6 is a matter to be determined in the light of all the circumstances of the case, having particular regard to situations where inferences may be drawn, the weight to be attached to them by national courts in their assessment of the evidence and the degree of compulsion inherent in the situation."

290. HMRC noted, by way of analogy, that Section 35 of the Criminal Justice and Public Order Act 1994, which permits a jury in certain circumstances to draw an inference from a defendant's failure to testify at trial, has been found to be Article 6 compliant. The European Court of Human Rights made clear in *Condron v UK* (35718/97) (2001) 31 E.H.R.R. 1 that it is the judge's direction to the jury on the drawing of inferences which is of particular importance. HMRC submitted that the following steps, tailored and adopted for the purposes of this appeal, can properly be considered as "adequate safeguards":

> (a) the judge must tell the jury that the burden of proof remains in the prosecution throughout and must advise the jury of the required standard;
>
> (b) the judge must make clear to the jury that the defendant has the right to remain silent;
>
> (c) an inference from a failure to give evidence cannot on its own prove guilt;
>
> (d) the jury must be satisfied that the prosecution have established a case to answer before drawing inferences from silence;
>
> (e) if, having considered the defence case, the jury concludes that the silence can only sensibly be attributed to the defendant's having no answer or none that would stand up to cross-examination, they may draw an adverse inference.

291. HMRC submitted that Waterfire, through the Appellant as director, knowingly acted as a contra trader in VAT period 04/06 as part of a scheme intended to defraud the Revenue. In particular HMRC rely on its conduct on entering into the following transactions and submitting a VAT return signed by Mr Butt on 15 May 2006 seeking a repayment of VAT:

- 32 broker transactions;
- 6 buffer transactions; and
- 47 acquisition transactions.

292. HMRC also relied upon the nature of Waterfire's dealings in 07/06, which it submitted are indicative of an overall scheme to defraud the Revenue. In particular HMRC submitted that Waterfire knowingly entered into the following transactions as part of a fraudulent scheme:

- 14 broker transactions;
- 0 buffer transactions; and
- 17 acquisition transactions.

293. HMRC noted that the Appellant has not challenged HMRC's case that the loss of VAT was attributable to fraud in the chains traced back to defaulters in 04/06 and 07/06 or in the 5 distinct chains (the Epinx transactions) where Waterfire purchased from a contra trader.

294. HMRC submitted that the following features of the transactions demonstrate that they formed part of an orchestrated and contrived scheme to defraud the Revenue and of which Waterfire, through its directors, knowingly participated:

(a) Waterfire's VAT declarations during its effective period of trade (7 October 2004 to 28 July 2006) reveal that its turnover increased nine-fold between 2005 and 2006:

- Year end 31 July 2005 £17,130,164
- Year end 31 July 2006 £168,843,683
- Year end 31 July 2007 £1,395

(b) There is a significant inconsistency between the turnover declared by Waterfire in its VAT returns and the turnover declared by Waterfire in its annual accounts; the company declared a turnover of £185,976,637 on its VAT returns during the period in question yet it declared £17,514,662 for the corresponding period in its annual accounts;

(c) Waterfire achieved a near-perfect balancing of its VAT liabilities over a six month period, despite a turnover of £102,000,000;

(d) Each of Waterfire's broker and buffer deals in periods 04/06 and 07/06 can be linked to fraudulent tax losses, either directly or via a contra trader;

(e) The deal chains involved no manufacturers, authorized distributors, retailers or end users;

(f) Waterfire did not add value to the deals chains; a trader adds value for example by (i) breaking down bulk; (ii) accumulating stock; (iii) holding and storing stock; (iv) sourcing scarce products from unique personal contacts; and (v) providing finance. None of these examples apply to Waterfire and the Appellant had provided no explanation as to how his company added value to the deal chain;

(g) The transaction chains in respect of Waterfire's acquisition chains were relatively short, generally involving only one other UK company which acted as broker. In contrast, the transaction chains in respect of Waterfire's broker chains features 6 or 7 UK participants;

(h) According to the sales and purchase invoices provided by Waterfire, the company tended to trade during the last 10 days of each month (80% of deals in 04/06 and 07/06);

(i) Waterfire never made a loss on any transaction;

(j) Waterfire increasingly achieved high profit margins on both its EU purchases and its EU sales as compared to those transaction where it purchased and sold to UK traders;

(k) Consistent mark-ups were made by traders in the deal chains;

(l) The transaction chains display non-commercial features such as the appearance of particular traders occupying the same position in transaction chains in deal chains purported to be unconnected, documentation includes inadequate and/or inconsistent information, there is a lack of underlying paperwork to evidence transactions and the terms

of dealing are confused with no clarity as to matters such as legal title, date of delivery, date of payment or redress;

(m) The six buffer deals in 04/06 involved sales to three different but connected companies which each sold to EU customers already known to Waterfire with Waterfire, therefore, foregoing a much larger profit by not selling to the EU. There was no need for Waterfire to import goods in its acquisition deals or sell to UK traders; the goods could have been sold to Waterfire's existing EU contacts at a greater profit. The only reason for goods to enter the UK was to bring them into the UK VAT regime, creating an output tax charge by the contra trader and a subsequent VAT repayment claim by the broker;

(n) Every transaction within the analysed chains in periods 04/06 and 07/06 invoiced in Sterling irrespective of whether the goods were being acquired from the EU or sold to the EU;

(o) Analysis of the FCIB material demonstrates that money flows were circular and involved similar patterns of traders and third party payments outside the UK without any reasonable commercial explanation;

(p) Analysis of the FCIB material demonstrates the participation within a single deal chain of more than one company run by the same director;

(q) Analysis of the FCIB material demonstrates that common IP addresses were used to make payments for companies in geographically diverse locations and the making of third party payments by other companies in the overwhelming majority of Waterfire's supply chains;

(r) The deals with Epinx enabled the Epinx to balance its VAT account and to generate a significant repayment claim by Waterfire which would not trace directly to a tax loss;

(s) In each of the 14 broker transactions in 07/06 the goods were despatched to the same warehouse in France (Entrepots Surete France SARL) notwithstanding that Waterfire had 6 different customers based in 6 different locations. In at least 10 of the 17 acquisition deals in 07/06 the ultimate broker also despatched the goods to Entrepots.

295. HMRC submitted that had Waterfire bought from and sold to the EU in the same transaction chain its profit margin would have increased by avoiding transport costs (which were borne by Waterfire when it acted as both acquirer and dispatcher) and it would have avoided any liability to VAT. HMRC also highlighted that Waterfire had the trading relationships to trade in this way. For instance it had bought from and sold to FAF International on a number of occasions yet on no occasion when FAF was the ultimate customer in Waterfire's acquisition deals did the two companies find each other: In deal 183 Waterfire purchased from FAF; in deals 186 and 187 FAF purchased from Totel Ltd which had purchased from Waterfire. All three transactions took place on the same day, 26 April 2006.

296. HMRC submitted that the following features indicate that Waterfire, through the Appellant and Mr Tahir, knew that the transactions formed part of an overall scheme to defraud the Revenue:

(a) The Appellant's awareness of the risks and prevalence of MTIC fraud in the mobile phone sector;

(b) The nature and content of the VAT1 signed by the Appellant demonstrated an intention to deceive HMRC as to the true nature of the business in that the business activities were described as *"wholesale of fancy goods, wholesale and retail of electrical equipment and white goods and consumer electronics."* As compared with the Appellant's representative informing HMRC on 28 July that the business would involve the *"wholesale purchase and supply of mobile handsets"*;

(c) The Appellant's involvement while employed by Square 1 in 5 transactions in 09/03 in which circularity of payments was identified by HMRC and in respect of which the input tax claimed by Square 1 was denied (although the decision was later reversed following the decision of the CJEU in *Bond House*);

(d) The inadequate and superficial checks carried out on trading partners and the Appellant's failure to act on negative indicators;

(e) The back-to-back nature of the transactions and the ease with which Waterfire was able to generate consistent mark-ups and significant profits on enormous turnover;

(f) The use of an FCIB account and the use of such accounts by its trading partners which indicates that Waterfire knew that the movement of funds was orchestrated;

(g) The limited evidence of price negotiations and the fact that goods were bought and sold at margins which followed non-commercial patterns and did not vary according to commodity, model or quantity;

(h) Waterfire's continued trade with Gee-Tec and International Electrical Distributors Ltd in periods 04/06 and 07/06 notwithstanding that the Appellant had been advised by HMRC that goods previously purchased from these companies had traced back to tax losses;

(i) The fact that whether it was acting as acquirer, broker or buffer the goods were never held by or despatched to a warehouse chosen by Waterfire;

(j) Waterfire's refusal to obtain IMEI numbers on the basis of cost which HMRC submitted would have been minimal when compared to the profits being generated and which indicates a refusal by the Appellant to protect against obvious and significant risks;

(k) The inadequate inspections of the goods commissioned by Waterfire which often cursory and only involved a simple box count where transactions averaged a value of £767,000;

(l) The inconsistent explanations provided as to whether the goods were insured; Mr Butt and Mr Tahir having told HMRC on 21 June 2006 that their customers took responsibility for insurance and the Appellant subsequently stating on 26 October 2006 that the supplier insured them.

297. HMRC highlighted the following features of Waterfire's finances; HSBC banking records provided to HMRC for the period April 2005 to April 2006 showed these payments:

- 5 April 2006 - £205,000 - Return of Director's loan
- 27 July 2006 - £125,000 - Dividends (Bonus)
- 10 August 2006 - £200,000 - Return of Loan – Umaad Butt

298. It was noted by HMRC that on 21 June 2006 the Appellant told HMRC officers that the company had no outstanding loans, which appears at odds with the payments set out above. On 17 October 2006 Mr Mody wrote to Waterfire requesting details of all bank accounts operated by the company and full details of any investments in, or funding of Waterfire. No response was ever received and the Appellant has never provided an explanation for the banking anomalies.

299. The liquidator also identified the following two payments from the account:

- 19 October 2006 - £400,000 - Director's Loan
- 24 October 2006 - £417,902.09 - Director

300. HMRC noted that there is no documentation to support either the repayment of the loans or the loan to the Appellant; other than a payment into the account of £200,000 identified by the Liquidator, no other repayments have been made.

301. On 21 June 2006 during a VAT assurance visit the Appellant told HMRC officers that on initial set up his family provided £200,000 to enable trading to commence and that there were no outstanding loans to the business. On 9 February 2010 during an interview with the official receiver when asked what money he had taken out of Waterfire during his time as director, the Appellant stated that between the start and cessation of trading he had only taken dividends of between £100,000 and £125,000. HMRC submitted that in view of the payments identified above, the Appellant had lied in interview.

302. Documents produced during the proceedings and contained in a disclosure file identified that payments to the Appellant in 2006 exceeded £1,000,000. HMRC relied on this evidence to demonstrate the dishonesty of Mr Butt who had stated in his insolvency interview:

"From mid 2006 until my resignation in 2009 the company did no trading…When we ceased trading the only assets the company had, were old desks and PCs that were sold for a few hundred pounds."

303. HMRC drew our attention to *Phillipou* (1989) 89 Cr App R 290 (approved by the House of Lords in *Gomez* (1993) 96 Cr. App. R 359) in which the Court held that a director who owned shares in a company could still be convicted of theft from that company. HMRC drew the comparison with the actions of the Appellant in appropriating property belonging to Waterfire with the intention of permanently depriving the company of that property which constitutes theft.

304. Waterfire failed to pay or account for corporation tax; its return for the year to 30 April 2006 was submitted but not paid. The return declared a turnover of approximately £152,000,000 and a profit of approximately £401,000. The net profit for that period according to the records based on purchases of £151,767,634.20 and sales revenue of £153,762,964.75 was £1,995,330.55. HMRC submitted that given the

directors did not receive wages, only dividends, and the full time employee Mr Sharif only received £17,083 wages in the tax year 05/06, it can be concluded that the profits were under-declared. For the following year to 30 April 2007 no corporation tax was submitted nor any tax paid.

305. HMRC noted that the Appellant was a director of Waterfire from 16 June 2004 to 26 June 2009. Mr Phil Royle was appointed a director on 11 October 2008. The accounts for the year ending 30 April 2006 are inaccurate; they were signed off by Mr Royle on 13 April 2009 however HMRC highlighted the fact that the Appellant was, at that point, still a director with responsibility for the accuracy of the accounts. In the alternative, HMRC submitted that the Appellant had a duty prior to the sale of the company to produce accounts up to the time the company ceased trading. It was submitted by HMRC that the Appellant failed to do so in order to hide his theft from the company and avoid corporation tax.

306. HMRC highlighted further financial anomalies relating to the Appellant, including failure to declare rental income on properties and a transaction undertaken in 01/06 by Waterfire (UK) Ltd, which was not registered for VAT, in which it had purchased goods from outside the UK and sold to Waterfire. Waterfire claimed the deduction of input tax however Waterfire (UK) Ltd did not account for or pay the output tax to HMRC thereby causing a loss to the Revenue of £247,298.63.

307. As regards HMRC's witnesses, it was submitted that the test for the Tribunal to apply is whether or not on the evidence presented to the Tribunal by HMRC has proved on the balance of probabilities that the statutory criteria in section 61 VATA 1994 is satisfied. Whether the witnesses had considered all information or based their conclusions on hearsay is irrelevant. The Tribunal can disregard non-expert opinion evidence. Furthermore, HMRC submitted that much of the opinion evidence given was elicited in cross-examination by the Appellant's representatives despite the Tribunal having stated prior to the proceedings that it would disregard any such evidence.

308. As regards the evidence of Ms Sharkey HMRC submitted that her task had been to trace the money flows; any inferences to be drawn from that factual evidence is a matter for the Tribunal. Ms Sharkey was not challenged as to the accuracy of her tracing exercise and the core material underlying the analysis was provided to the Appellant. Similarly, Mr Humphries described patterns of trading found from available documents. There was no challenge to his factual analysis and again, any inferences to be drawn are a matter for the Tribunal. HMRC accepted that despite Mr Stone's significant experience of MTIC fraud, his opinion was irrelevant.

309. As to the VAT sought to be evaded HMRC submitted that this was the amount of input tax credit claimed by Waterfire in its VAT return for period 04/06, namely £6,972,184.

310. On the issue of quantum of the penalty, HMRC relied on *Han and others* in which the Court of Appeal highlighted the deterrent nature of civil penalties (see [48])

311. Finally, it was submitted by HMRC that if the allegations are proved, the penalty is proportionate and there is no reason for the Tribunal to reduce it.

<u>Discussion and decision</u>

312. We will address each of the parties' legal submissions, our conclusions in respect of which set the basis for the test we have applied, before we turn to our findings on the evidence and whether HMRC has discharged the burden of proof.

Construction of legal principles and legislation

313. We agreed that the 04/06 VAT return submitted by the Appellant was arithmetically correct and accurately represented the taxable supplies which were made during the relevant period. Indeed, this was not a point that was challenged by HMRC. However we did not agree that at the relevant time there was no legal provision or authority by virtue of which the Appellant's entitlement to input tax could be refused.

314. We were satisfied that VATA 1994 provides sufficient justification for HMRC to refuse input tax credit in circumstances where a trader enters into a transaction which he knows or should have known is connected with fraud, per Moses LJ at [47] of *Mobilx*:

> *"… the objective criteria which form the basis of concepts used in the Sixth Directive form the basis of the concepts which limit the scope of VAT and the right to deduct under ss. 1, 4 and 24 of the 1994 Act. Applying the principle in Kittel, the objective criteria are not met where a taxable person knew or should have known that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT. That principle merely requires consideration of whether the objective criteria relevant to those provisions of the VAT Act 1994 are met. It does not require the introduction of any further domestic legislation."*

315. We were taken through the evolution of cases involving HMRC's decisions in respect of economic activity and subsequent "MTIC cases". Having considered the parties' submissions we reached the following conclusions:

316. *Optigen* dealt with the situation in which the taxpayer was an innocent party; the issues of knowledge and means of knowledge were not issues before the Court however it did make reference to, and in doing so acknowledged the knowledge/means of knowledge issues and made it clear that an entitlement to input tax credit required the objective criteria to be fulfilled (at [55]):

"Therefore, the answer to the first question referred for a preliminary ruling in each case should be that transactions such as those at issue in the main proceedings, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge. The right to deduct input VAT of a taxable person who carries out such transactions cannot be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing."

317. The clear assumption from *Optigen* was that it indicated that a trader with knowledge of fraud forfeited the right to deduct. The case of *Kittel* developed what, in our view, was an established and clear principle. At [50] – [57] the Court said:

"… it is apparent 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 (see, to that effect, Case C-384/04 Federation of Technological Industries and Others [2006] ECR I-0000, paragraph 33).

It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity' are not met where tax is evaded by the taxable person himself (see Case C-255/02 Halifax and Others [2006] ECR I-0000, paragraph 59).

As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive…

Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 Rompelman [1985] ECR 655, paragraph 24; Case C-110/94 INZO [1996] ECR I-857, paragraph 24; and Gabalfrisa, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see Fini H, paragraph 34).

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

That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice."

318. The development in *Kittel* was concerned with the means of knowledge test which is irrelevant to the present appeal; it is the case for HMRC that the Appellant was fully aware and deliberately organised his trading in such a manner as to conceal and facilitate fraud.

319. We considered the submission made on behalf of the Appellant, relying on the Opinion of the Advocate General in *Kittel,* that knowledge of fraud was irrelevant if

the taxable person did not participate or derive a benefit. We noted the Opinion stated:

It asks specifically whether, in a 'carousel' fraud, that effect on the validity of a contract of sale precludes the deduction of input VAT, in two situations, according to whether the buyer acts in good faith (Case C-440/04) or participates in the scheme (Case C-439/04).

The judgment of 12 January 2006 in Optigen and Others provided an answer in the first situation, allowing the taxable person to deduct the VAT if he is unaware that the transaction is part of a broader stratagem to defraud the Treasury of funds.

As I mentioned in the introduction to this Opinion, the solution to this dilemma is provided in the judgment in Optigen and Others which, in that situation, left the right to deduct intact.

There is little or nothing to add at this point, not only because that judgment is recent but also, fundamentally, because it is correct. Referring to the objectivity of the terms of the Sixth Directive (paragraphs 43 to 45) and to the general organisation of VAT, which is governed by the principle of neutrality and precludes any distinction as between lawful and unlawful transactions (paragraph 49), the Court of Justice held that transactions unconnected with the fraud are taxable transactions, inasmuch as they are effected by a taxable person, who does not lose his right to deduct it if, without his knowledge, those transactions form part of a chain of unlawful trade (paragraphs 51 to 54).

The solution is not so clear-cut where the buyer is aware of the ruse. In this situation, there are two possibilities: (1) he knows about it but does not participate in it or derive any benefit from it, or (2) he participates in the fraud, and profits unlawfully.

1. The first possibility

Here the reply should not differ from the reply in respect of a taxable person who is unaware of the deceit.

The neutrality which governs this tax precludes the exclusion from the scope of its rules of business transactions which are part of its subject-matter. The judgment in Optigen and Others reiterated that the right to deduct is exercised regardless of whether the VAT on other previous or subsequent transactions has been paid or not (paragraph 54).

2. The second possibility

If everyone participates, the scheme in itself constitutes a fraud, since it is designed to evade tax.

Furthermore, if a Member State fails to take action, it would be contrary to the most basic logic to tolerate the deceitful conduct and leave it free of legal penalty.

The crux of the matter is therefore to clarify whether the prohibition against abuse of rights also applies to VAT.

I agree with my colleague that there is nothing to prevent that maxim applying to the VAT sector. What is more, preventing tax evasion is an objective recognised and

encouraged by the Sixth Directive in the articles devoted to exemptions, as was pointed out in the judgment in Gemeente Leusden and Holin Groep and later reiterated in the judgment in Halifax and Other. Taxable persons must not be allowed to rely on the Community VAT provisions in order to obtain an advantage which is contrary to their purposes.

The second element relates to the purpose of the operation, which is none other than to create the right claimed, and obtain an undeserved profit. It appears to be essential that the person claiming the discount be both aware of the fraud and in agreement with the other participants, so that the contract, having no independent financial content, is simply a smokescreen for the profit.

…If there is no tax liability, because a stratagem has been created for the sole purpose of creating the right artificially, there is no need to compensate for a tax which, in fact, has not been paid. These considerations explain why the Court of Justice recognises the possibility that a right, even if it has arisen, may not be acquired, since, apart from it being subject to adjustments which may be made in accordance with the conditions laid down in Article 20 of the Sixth Directive, it is necessary that there be no fraud or abuse.

In short, the First and Sixth VAT Directives not only authorise, but demand that the holder lose this right if he knowingly participates in fraudulent chains of this kind, for the assessment of which the criteria set out above must be followed. On these lines, the judgment in Fini H held that it is a matter for the national court to refuse to allow the right to deduct where it is established that that right is being relied on for unlawful ends.

(Emphasis added)

320. It seemed to us that the circumstances in which the first possibility would arise would be highly unusual. In any event, we took the view it was unnecessary for us to consider the point further as it is irrelevant to the present appeal; the case for HMRC, is that the Appellant was aware of the fraud, participated in it and benefited from it. The issue we must determine is whether the statutory criteria of section 61 VATA 1994 are fulfilled which, on HMRC's case, falls squarely within the second possibility.

321. We rejected the Appellant's submission that where the objective criteria are satisfied, even if fraud is established, the right to deduct does not cease. On our reading Moses LJ made clear in *Mobilx* [41] – [43] (citing *Kittel* at [56] – [59]) that even where a transaction appears to meet the objective criteria, the participation of the taxable person in the fraud by his knowledge or means of knowledge has the consequence that the transaction falls outwith the scope of VAT and thereby does not satisfy the criteria required for the right to deduct to arise:

> *""56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.*
>
> *57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.*

58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

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

The words I have emphasised "in the same way" and "therefore" link those paragraphs to the earlier paragraphs between 53-55. They demonstrate the basis for the development of the Court's approach. It extended the category of participants who fall outwith the objective criteria to those who knew or should have known of the connection between their purchase and fraudulent evasion. Kittel did represent a development of the law because it enlarged the category of participants to those who themselves had no intention of committing fraud but who, by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions did not meet the objective criteria determining the scope of the right to deduct.

By the concluding words of § 59 the Court must be taken to mean that even where the transaction in question would otherwise meet the objective criteria which the Court identified, it will not do so in a case where a person is to be regarded, by reason of his state of knowledge, as a participant.

A person who has no intention of undertaking an economic activity but pretends to do so in order to make off with the tax he has received on making a supply, either by disappearing or hijacking a taxable person's VAT identity, does not meet the objective criteria which form the basis of those concepts which limit the scope of VAT and the right to deduct (see Halifax § 59 and Kittel § 53). A taxable person who knows or should have known that the transaction which he is undertaking is connected with fraudulent evasion of VAT is to be regarded as a participant and, equally, fails to meet the objective criteria which determine the scope of the right to deduct.

322. The Appellant sought to draw a distinction between a claim to VAT which is false by its having no legitimate basis and a claim to VAT which can subsequently be refused but which at the time of its making was not false. As we understood it, the Appellant relied on the distinction between a claim which was based on, for instance, wholly made-up figures as opposed to one which was arithmetically correct but later refused, for example on the basis of knowledge of fraud. We found this argument misconceived; HMRC's case is that the Appellant acted dishonestly by claiming input tax credits which he knew to be false as the claim was based on artificially constructed trading designed for fraudulent ends. We were satisfied that if proven, such a claim would be false even if the figures on the relevant return were arithmetically correct.

323. It seemed to us that the distinction to be drawn, and which is drawn by the authorities, is that of the right to deduct and the acquisition (as per the Advocate

General) or exercise by a taxable person of that right. If the objective criteria are not met (for instance by connection to and knowledge of fraud) the transaction falls outwith the scope of VAT and there is no right to deduct. In those circumstances the taxpayer does not acquire and is therefore not entitled to exercise that right; where a trader does so was described in *Kittel* in the following terms (at [55]):

"*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"*

324. To the extent that *Mobilx* and the decision in *Kittel* post-dated the submission by the Appellant of the relevant return we have already set out our conclusion that VATA 1994 provides sufficient justification for HMRC to refuse input tax credit in circumstances where a trader enters into a transaction which he knows is connected with fraud and we were satisfied that at the relevant time the principles established in *Optigen* were clear in respect of transactions which did not satisfy the objective criteria as a result of knowledge of fraud.

325. The Appellant's reliance on *Rimmington* reiterated counsel's submissions as to whether the law was sufficiently clear for the Appellant to know what conduct was forbidden at the time when the return was submitted to HMRC. We should note at this point that aside from the fact that we had no evidence as to what the Appellant did or did not know about the law at the time, in our judgment this was an irrelevant consideration. The test to apply in this case is that set out in the relevant provisions of VATA 1994. Furthermore it is an established principle that ignorance of the law provides no defence. We did not agree that no limitation to the right to reclaim existed other than input tax having been incurred or that our conclusion gave an untenably wide interpretation which is at odds with the principles set out in *Rimmington*. The concept of abuse is long-established; in order to exercise the right to deduct the objective criteria must be met.

326. In our judgment the principle to derive from the authorities is that where a trader uses EU law for abusive or fraudulent ends, the transaction is deemed not to have taken place and, as a result, the trader has loses the right to deduct.

327. We did not accept the Appellant's submission in respect of conforming interpretation. The penalty imposed on the Appellant is provided for by domestic law by virtue of Sections 60 and 61 VATA 1994. We were satisfied that we did not need to adopt the approach of conforming interpretation in order to determine whether the statutory requirements of the legislation were met. We did not agree that the Court of Appeal in *Mobilx* applied a conforming interpretation which cannot be extended to a penalty classified as criminal for the purposes of the ECHR and EU Charter. In our judgment Moses LJ clearly explained the position and in our judgment, that the penalty is classed as criminal for the purposes of the ECHR does not alter the situation [45] – [47]:

"...Art. 17.2, which confers the right to deduct, contains a reference back to the taxable transactions identified in Articles 5 and 6, and thus back to those objective criteria which form the basis of concepts such as "supply of goods effected by a taxable person acting as such" within the meaning of Articles 2, 4 and 5. Those criteria are transposed into domestic law by the Value Added Tax Act 1994.

...Accordingly, the objective criteria which form the basis of concepts used in the Sixth Directive form the basis of the concepts which limit the scope of VAT and the right to deduct under ss. 1, 4 and 24 of the 1994 Act. Applying the principle in Kittel, the objective criteria are not met where a taxable person knew or should have known that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT. That principle merely requires consideration of whether the objective criteria relevant to those provisions of the VAT Act 1994 are met. It does not require the introduction of any further domestic legislation."

Evasion

328. We considered the Appellant's submissions that the term "*evasion*" should be construed narrowly so as not to include a claim to input tax where genuinely incurred by the taxpayer and in respect of which there was a prima facie right to claim by virtue of Section 26 VATA 1994. In our judgment the word "genuinely" is where the Appellant's argument must fail; to be genuinely incurred requires the relevant transaction to go further than the simple fact of incurring input tax – the objective criteria must be fulfilled and is not so fulfilled where the requirements of the legislation are relied on for abusive or fraudulent ends. In such a situation there can be no prima facie right to deduct as the right is lost.

329. We found the case of *Dealy* to which we were referred was distinguishable on its facts and provided no assistance to us; in that case the Court of Appeal addressed the issue of evasion in the wholly different factual context of non-payment and whether Section 39 (1) VATA 1983 required proof of a permanent intention to deprive. On our reading of the trial judge's direction to the jury which was upheld by the Court of Appeal, the judge clearly set out the case in context and recognised that the direction was tailored to the facts of the specific case:

"'Evasion' is a word which can be put in a number of different ways and has been. Dodging a requirement is one method of looking at it. Avoiding payment is another method of looking at it..."

330. In our judgment the statute does not import the restrictions urged on us by the Appellant. Instead Section 60 (2) VATA 1994 includes the obtaining of a VAT credit "*in circumstances where the person concerned is not entitled to that sum.*" No further restriction is placed on the provision and we do not imply one. In our view the nature of the evasion, if it is found to exist, can take many forms including but not limited to *"dodging a liability"*.

331. We rejected the Appellant's submission that any evasion by Waterfire should not be confused with the wider evasion which is going on, which the Appellant submitted was irrelevant to the operation of Section 60 VATA 1994. If we have understood the Appellant's argument correctly, he seeks to persuade us that any evasion or fraud being carried out, irrespective of whether the Appellant knew about the fraud or not, has no bearing on and cannot form the basis of a penalty under Section 60 VATA 1994. We found this argument misconceived; the basis of the penalty was that Waterfire, through its directors, was part and parcel of that evasion. Profit is made by traders' participation the deals, which, but for the fraud, would not have taken place. Looked at in its totality, if the fraudulent scheme is successful HMRC fund the fraud by paying the broker, the defaulter evades liability, buffers earn profits from their participation in deals which otherwise would not have occurred as

does the contra-trader who conceals the tax loss and manufactures an output tax liability to offset an input tax credit.

332. In the context of this appeal we were not persuaded by the Appellant's submission that evasion requires dishonesty; if that were the case we queried why dishonesty is separately specified as a requirement of section 60 VATA 1994. We also noted the following reference in *Ermis*:

In the context of civil evasion penalties, it has been specifically held that mere carelessness, even recklessness, does not constitute dishonesty - see Stuttard v HMRC [2000] STC 342."

333. We concluded that the term evasion can include evasion by means of participation in fraud and lack of entitlement to a sum as a result of the loss of the right to deduct. Whether the requisite element of dishonesty is satisfied is a separate part of the test under section 60 VATA 1994 which we went on to consider.

Dishonesty

334. We did not accept the Appellant's submissions on the issue of dishonesty; in our view the Appellant's contention that HMRC allege dishonesty which does not directly relate to the conduct for which the Appellant has been penalised fails to recognise the basis of HMRC's case. The Appellant's reference to "collateral" dishonesty (namely the covering up of someone else's fraud) being irrelevant to Section 60 VATA 1994 is misconceived; it misses the point that there is no "collateral" dishonesty - the Appellant is alleged to be a knowing participant in the fraud and thereby dishonest.

335. In considering the Appellant's submission, we found it arguable that the statutory criteria would be met if the Appellant had deliberately covered up another's fraud on the basis that it could be deemed participation and thereby the element of dishonesty on his part would be satisfied. However we did not consider this point further because it is the case for HMRC that the Appellant's actions of contra trading were dishonestly and artificially engineered so as to facilitate a scheme of fraud thereby leading to his attempt to obtain a VAT credit.

336. We noted the Appellant's reliance on Judge Sinfield's approach in *Ermis* to the test for dishonesty. The *Ghosh* test is long established and the correct approach to adopt in determining the issue of dishonesty.

ECHR

337. The parties agreed that the Appellant's Article 6 and 7 rights were invoked. Where the parties seemed to diverge related to the applicability and effect of those rights on the proceedings. As we understood it, the Appellant appeared to suggest that proceedings became criminal in nature. We did not agree and we noted and adopted the comments of Potter LJ in *Han and Others* at [84]:

"It by no means follows from a conclusion that Article 6 applies that civil penalty proceedings are, for other domestic purposes, to be regarded as criminal and, therefore, subject to those provision of PACE and/or the Codes produced thereunder, which relate to the investigation of crime and the conduct of criminal proceedings as defined by English law. Any argument as to whether and how far that Act and the Codes apply is one which will have to be separately considered if and when it is

advanced. In this context, however, the specific provisions of s 60(4) VATA are plainly of considerable importance. I would merely add my view that, if matters are made clear to the taxpayer on the lines indicated in para 77 above at the time when the nature and effect of the inducement procedure are also made clear to him (whether by VAT Notice 730 or otherwise), it is difficult to see that there would be any breach of Article 6. It also seems to me that, even if PACE were applicable, it is most unlikely that a court or tribunal would rule inadmissible under s 76 or s 78 any statements made or documents produced as a result, at any rate in the absence of exceptional circumstances. On the other hand, it follows from this decision that a person made subject to a civil penalty under s 60(1) will be entitled to the minimum rights specifically provided for in Article 6(3)."

338. At [21] to [23] of *Han and Others* the court set out the *"minimum rights"* provided by Article 6:

"Thus, a finding that the imposition of a penalty gives rise to a criminal charge is the threshold condition for application of the substantive provisions of Article 6 to the civil penalty procedures under s 60 of VATA and s 8 of FA 94. If applicable, there are implicit in the fair trial provisions of Article 6(1) rights which include a right to silence and a privilege against self-incrimination.

Article 6(2) enshrines the presumption of innocence in criminal matters as follows:

"2. Everyone charged with a criminal offence shall be presumed innocent until proven guilty according to law."

Article 6(3) provides further "minimum rights" for those facing criminal charges:

"3. Everyone charged with a criminal offence has the following minimum rights:

(a) to be informed promptly, in a language which he understands and in detail, of the nature and cause of the accusation against him;

(b) to have adequate time and facilities for the preparation of his defence;

(c) to defend himself in person or through legal assistance of his own choosing or, if he has not sufficient means to pay for legal assistance, to be given it free when the interests of justice so require;

(d) to examine or have examined witnesses against him and to obtain the attendance and examination of witnesses on his behalf under the same conditions as witnesses against him;

(e) to have the free assistance of an interpreter if he cannot understand or speak the language used in court.""

339. The Appellant's arguments in respect of Article 6 covered a number of areas and we will deal with each in turn.

340. The application to recuse was heard and the full decision issued prior to the substantive hearing. However the Appellant reiterated in his closing submissions his argument that the failure of Judge Blewitt to recuse herself breached the Appellant's Article 6 rights. The basis of this argument is the perception of bias. As this was the basis of the Appellant's oral argument when the application was heard, the decision in

respect of which may yet be subject of an application for leave to appeal, we intend to confine our comments to these: the Appellant's application for summary judgment was premised on the basis of legal argument without any evidence being called or considered. The legal test to apply was entirely different to that applicable to this appeal; as recognised by the Upper Tribunal the issues were not pre-judged or determined but rather the test applied was whether Judge Blewitt was satisfied that HMRC's case, or part of it, had no reasonable prospect of succeeding such that it should be barred from taking part in proceedings. In contrast, this appeal has been decided on findings of fact from the evidence heard together with our determination of the legal arguments of the parties. The decision was reached by this Tribunal without regard to the test applied in the application for summary judgment. We do not agree that the Appellant's Article 6 rights have been infringed by the summary judgment decision.

341. The Appellant also submitted that the decisions in respect of disclosure breached the Appellant's Article 6 rights and deprived the Appellant of equality of arms. As we understood the submission, the Appellant's representatives were given insufficient time to prepare and thereby raise and address issues relevant to the presentation of the case. We rejected this submission for the following reasons: the Appellant was represented by counsel who was instructed in December 2013; the Appellant subsequently had the benefit of counsel leading a junior; the appeal was fixed at a directions hearing before Judge Barlow on 19 December 2013 at which the hearing date of 16 to 27 June 2014 was identified and at which Counsel for the Appellant was present; and no reasons were given as to why the Appellant's representatives could not prepare the case in the six month window leading up to the substantive hearing.

342. As to the Tribunal's approach of *"requiring the Appellant to justify the relevance and materiality of the disclosure sought"*, the decision on disclosure dated 14 May 2014 confirmed that Judge Blewitt had considered the relevant principles governing disclosure, the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 and the issues in the appeal. The approach taken bore in mind that the burden to be imposed on HMRC must not be excessive and the disclosure required must be of relevant material and not simply sought as a tactical device. The decisions were not to our knowledge appealed. The Appellant's observations appear limited to him having insufficient time and resources. It is unnecessary to comment on these matters beyond reiterating the comments above; the Appellant had the benefit of two barristers and the hearing was fixed taking into account counsel's availability. The Appellant referred to Judge Blewitt's decision not to vacate the substantive hearing, which has already been the subject of an appeal to the Upper Tribunal. We do not accept that the refusal to adjourn the substantive case infringed the Appellant's Article 6 rights.

343. It is true, as contended by the Appellant, that HMRC's case goes beyond matters within the Appellant's direct knowledge and relies on circumstantial evidence. That is the nature of many appeals before this Tribunal and a matter to which the Tribunal has regard in reaching its findings of fact. However it is not correct to say that the Appellant was restricted in its disclosure to matters of direct relevance to the Appellant's state of mind; this was identified as one of the principle issues relevant to the substantive appeal but it remained open to the Appellant to make any further disclosure application it thought appropriate. The Tribunal in no way

restricted this right and we therefore reject the submission that the Appellant's right to a fair trial was infringed.

344. As regards the Appellant's right to silence, we fully accepted that there was no requirement for the Appellant to give evidence. We also accepted that the Appellant's Article 6 rights were engaged and he was entitled to the "minimum rights" set out above and that safeguards should be applied to protect the Appellant's right.

345. In our view the Appellant's submissions as to the right to silence and adverse inferences confused the two issues. It seemed to be suggested that to draw adverse inferences from the Appellant's failure to give evidence would automatically amount to an infringement of his Article 6 rights (although we noted that alternative arguments were also advanced which we will deal with in due course). We rejected this proposition. The right to silence having been exercised, as was the Appellant's right, we went on to consider HMRC's invitation to draw adverse inferences from that silence. We considered the authorities to which we were referred. We adopted and applied the principles enunciated in *Sunico,* and by the European Court of Human Rights in *Murray* and *Adetoro* as follows:

(i) We were satisfied that the Appellant as one of the two directors of Waterfire with responsibility for conducting the transactions might properly be expected to have material evidence to give on matters in issue in this appeal;

(ii) We bore in mind that any adverse inferences drawn by us may strengthen the evidence adduced by HMRC on an issue or weaken the evidence of the Appellant which was limited to Mr Butt's statements;

(iii) We did not reach our decision solely on the basis of adverse inferences drawn but, as will become apparent, from the cumulative findings on the evidence as a whole;

(iv) We were satisfied that HMRC had established a prima facie case supported by evidence;

(v) No reason was given at the time for the Appellant's silence. In closing submissions it was contended that there were no matters upon which the Appellant could comment and the case against him was unclear. We rejected that explanation; the case for HMRC has been clearly pleaded and was supported by evidence. The various matters upon which the Appellant could comment, if he so chose, were highlighted throughout the pleadings and witness statements. We were satisfied in those circumstances that there was no reason and no credible explanation for the Appellant's silence such that we should not draw adverse inferences or mitigate the effect of such inferences.

346. We bore in mind all of the circumstances of the case and balanced the weight to be attached to the inferences drawn in the light of the evidence as a whole.

347. We found the Appellant's interpretation of the principles was not supported by the authorities. We did not accept that to draw adverse inferences would breach the Appellant's Article 6 rights and we noted that the ECJ in *Condron* confirmed in a criminal context that in certain circumstances it was permissible for a jury to draw such inferences. We took the view that the following safeguards and caution had protected the Appellant's rights:

- The Appellant was represented by leading and junior counsel;
- The Tribunal confirmed with counsel upon being advised that the Appellant would not give evidence that he had been properly advised as to the potential consequences of his failure to give evidence;
- HMRC put the Appellant and the Tribunal on notice that they would invite the Tribunal to draw adverse inferences if the Appellant failed to give evidence.

348. As to whether HMRC has made out its case or the inferences to be drawn support the allegations is a matter we will come to in due course in our analysis of the evidence.

349. We found the Appellant's submission that the Tribunal should have considered the issue of the Appellant's right to silence as a preliminary matter and put in place safeguards to protect his rights misconceived. Whether an appellant chooses to give evidence or not is a matter for that appellant. In this appeal the Appellant had the benefit of the safeguard of legal representation and advice and the decision that the Appellant would not give evidence was only confirmed to the Tribunal following HMRC closing its case. The Tribunal was not invited to consider the issue as a preliminary matter. Had it been so it may well have declined to do so; it is not for the Tribunal to advise the Appellant nor would it be in a position to do so prior to hearing the appeal. It is only after consideration of the evidence and submissions that we could reach a decision as to whether it was appropriate to draw adverse inferences. It was submitted by the Appellant that a hearing on the issue was not requested as *"there are only so many applications that one can make before it becomes impossible to reasonably make any further"* (Transcript day 8 page 50). That is not a matter upon which we can comment; it was a matter for the Appellant and his legal representatives. It was open to the Appellant to make any number of applications he believed were relevant to the appeal; any application is dealt with on its merits by the Tribunal.

Validity of penalty

350. The Appellant did not appear to pursue its argument that HMRC had failed to give notice of the penalty. However it was clarified by HMRC that notices of the civil penalty were served on the Appellant, Waterfire and Mr Tahir on 29 March 2010. We have therefore not considered this matter further.

Terminology

351. We will set out in due course the approach we took to this appeal and the test we applied in reaching our decision. As previously stated, the use of common terminology within this decision does not pre-judge any issues but is used to assist the reader's understanding.

Reliance on the Article 7 of the ECHR and Articles 49 and 50 EU Charter

352. For reasons we have already set out we rejected the Appellant's submission that *Mobilx* is the only basis for HMRC's allegation that Waterfire evaded tax by making a claim for input tax to which it was not entitled. We were wholly satisfied that the law at the relevant time was clear and long established having been enshrined in statute by VATA 1994. We took the view that *Kittel* did not establish a *"novel development"* in the law nor did it enunciate any new legal principles. In those circumstances we were satisfied that the imposition of a penalty under Section 61 VATA 1994 did not breach Article 7 of the ECHR or Articles 49 or 50 of the EU Charter and we were satisfied that this was not an issue that should be referred to the CJEU.

Refusal of the right to deduct and right not to be punished twice

353. We did not accept the Appellant's argument that the imposition of a penalty under VATA 1994 breached Article 50 of the EU Charter in that it is a second penalty, the right to deduct being a penalty which has already been imposed. As highlighted by the Appellant, the Courts have at various times used the word penalty in reference to the right to deduct. However we noted that *Mahagében,* in which the term "penalty" was used in this context, also referred to it as *"the benefit of the right"* elsewhere in the judgment. Similarly in *Bonik*, also relied upon by the Appellant, the CJEU gave the following description at [43]:

"Consequently, since the refusal of the right of deduction is an exception to the application of the fundamental principle constituted by that right..."

354. We were not satisfied that the use of the term *"penalty"* by the CJEU in reference to the right to deduct, particularly when described in the same judgments as a *"right"* or *"benefit"* demonstrates that the refusal of the right to deduct is to be viewed as a penalty. We have already set out our conclusions as to the distinction between the right arising where the objective criteria are fulfilled and the exercise of that right which can be denied. In our view this accords with the judgment of Moses LJ in *Mobilx* at [65] which clearly states:

"The Kittel principle is not concerned with penalty... No penalty is imposed; his transaction falls outwith the scope of VAT and, accordingly, he is denied the right to deduct input tax by reason of his participation."

355. We considered the Appellant's reliance *on Halifax and Others* which stated that a finding of abusive practice must not lead to a penalty. In our judgment what was said by the Court at paragraph 93 does not apply to this appeal in respect of the right to deduct; by denying the right to deduct HMRC deny a benefit (the reduction of a VAT liability or a repayment of VAT) to which the trader is not entitled. A denial of a benefit to which there is no entitlement cannot, in our judgment, be equated to a penalty.

356. For those reasons we were satisfied that the imposition of a penalty under VATA 1994 did not amount to a second penalty and as such there was no breach of Article 50 of the EU Charter.

Witnesses

357. The Appellant raised a number of issues arising from the evidence of HMRC's witnesses. First, it was said that the witnesses did not have the relevant expertise to give evidence. In fact it was only the evidence of Mr Fletcher that was presented as expert opinion. The remainder of the witnesses were not put forward as experts and we did not treat them as such. Second, the Appellant submitted that the witnesses did not have sufficient business acumen or commercial knowledge to give evidence, as the witnesses had never traded in the mobile phone sector. Indeed the Appellant extended this lack of knowledge to the Tribunal, submitting that it would be unable to reach conclusions on the basis of its own lack of such experience. We did not agree; the witnesses raised a number of issues and anomalies from which they invited the Tribunal to draw inferences. That the witnesses had not worked in the industry in question does not in our view prevent them from applying common sense and reason to the facts. The analysis of that evidence and inferences to be drawn is a matter for this Tribunal which is a specialist tribunal experienced in such matters. To the extent that *Kittel* applies we have applied an objective test to reach our judgment. As the ECJ said in *Kittel*, at [61]:

> *"... 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."*

358. The issues of bias and opinion can be dealt with together. The witnesses were called to give evidence of fact. We did not consider any views expressed by the witnesses as to do so would have been wholly wrong. The test to apply is not the reasonableness of the original decision by HMRC but rather whether on the balance of probabilities HMRC have proved their case such that we are satisfied that the statutory criteria are met. We did not agree that HMRC's witnesses were "institutionally biased"; personal opinions were elicited as a result of the lines of cross-examination and we ignored them.

359. This may be an appropriate point at which to deal with the Appellant's request that Judge Blewitt provide reasons as to why it was indicated at the summary judgment hearing, in response to the Appellant's submission, that the tribunal would "disregard" rather than "exclude" the opinions of non-experts. I should reiterate that Mr Wilson was not present at the summary judgment hearing and took no part in that decision; he is therefore unable to comment on my reasons which I now set out in this paragraph. The objection to opinion evidence of non-experts was properly made by the Appellant. This was a case with a significant volume of lever arch files and given the proximity between the summary judgment hearing and the substantive hearing (by which time all if not the majority of the evidence had been served) I considered it excessively onerous and a costly exercise for HMRC to direct that they identify and redact each and every statement which contained opinion evidence. This Tribunal regularly deals with the evidence of witnesses and is fully able to ignore any views or opinions expressed to reach its own independent conclusion. The use of the term "disregard" was intended to convey the fact that we would not take into account any opinion evidence expressed by non-expert witnesses; the term "exclude" could just as easily have been used as the intended practical effect is the same.

360. As to the Appellant's argument that the witnesses called on behalf of HMRC gave hearsay evidence, for instance having reviewed documents prepared by other officers of HMRC, we bore this in mind in assessing the quality and reliability of the evidence and the weight to be attached it.

Summary

361. Before setting out our evaluation of the evidence it may be helpful to summarise our conclusions in respect of the principal legal submissions made by the parties which formed the basis for the approach we adopted. Our conclusions were as follows:

(1) HMRC had not misconstrued the relevant legal principles;

(2) At the relevant time, the right to deduct could be lawfully refused;

(3) The Appellant's rights under Article 6 were not infringed by the imposition of a penalty under Section 61 VATA 1994 or by the various case management decisions in the appeal proceedings prior to the substantive hearing;

(4) There was no breach of the Appellant's rights under Article 7 of the ECHR or Articles 49 and 50 of the EU Charter;

(5) The refusal of the right to deduct was not a penalty.

Consideration of the evidence

362. In general we found the witnesses called on behalf of HMRC reliable and credible. There was no substantial challenge to the factual evidence presented and the Appellant's submissions regarding the evidence did not in our view undermine it to any material extent for the reasons we have set out at [354] to [357] above.

363. As regards the Appellant's submission that the evidence relied upon by HMRC was circumstantial, we noted and respectfully agreed with the Court of Appeal's comments in *Dadourian Group International Ltd v Simms [2009] EWCA Civ 169*:

"… At times [counsel] came close to suggesting that fraud can only be established where there is direct evidence. If that were the case, few allegations of fraud would ever come to trial. Fraudsters rarely sit down and reduce their dishonest agreement to writing. Frauds are commonly proved on the basis of inviting the fact-finder to draw proper inferences from the primary facts…"

364. We found the evidence of Mr Lyon and Mr Mody compelling. We bore in mind that they had relied on the work of others but we were satisfied that there was no basis upon which to doubt the evidence before us. We noted that the exhibits annexed to their statements supported the facts put forward and that the evidence of the two witnesses accurately reflected the contents of documents such as visit reports and contemporaneous notes of conversations with the Appellant in respect of which there was no contradictory evidence such as would have undermined the evidence of the officers.

365. As regards the evidence of Ms Sharkey, we were satisfied that the sampling was fair and reasonable. We concluded that the large number of money flows traced by Ms Sharkey provided an extensive and accurate overview from which we could

reasonable draw conclusions. It must also be noted that the Appellant did not challenge the accuracy of Ms Sharkey's tracing exercise. The Appellant's argument that Waterfire always featured in the chains sampled because Ms Sharkey started with the company reflects the fact that this appeal is concerned with Waterfire's trading during the relevant period and the wider circumstances of that trading; we are not concerned with the transactions of other traders. We found Ms Sharkey's evidence of circularity in money flows, similar patterns of traders, shared IP addresses and third party payments compelling evidence that Waterfire's transactions were part orchestrated and part of an overall scheme to defraud. However we found that this was the limit of Ms Sharkey's evidence, which did not assist us in determining the issue of whether the Appellant knew that Waterfire's transactions were connected with fraud.

366. The evidence of Mr Stone was generic and did not assist us in determining the issues specific to Waterfire or the Appellant.

367. We did not find the evidence of Mr Milroy, which related to criminal prosecutions, relevant to the issues that we had to determine.

368. We accepted the evidence of Mr Humphries demonstrated that a cell or network of traders operated in a manner indicative of an overall scheme to defraud and of which Waterfire was a part. However we concluded that this evidence did not assist us in determining matters specific to the Appellant such as dishonesty.

369. We accepted Mr Fletcher's evidence which provided detail as to the grey market generally and features of trade which could be considered indicative of legitimate grey market trading. We did not consider his was undermined by the absence of any reference to his duties as an expert witness; Mr Fletcher confirmed in cross-examination that his evidence was consistent with the provisions in the CPR. We were also satisfied that his evidence was not undermined by the fact that he had never traded in the grey market. We took account of Mr Fletcher's lack of specific consideration of the impact of VAT administration, although we noted and accepted his general comments that delayed repayment claims may impact on a trader's cash flow although he did not agree that importing goods to produce an offset would be either helpful or prudent.

370. On the basis of Mr Fletcher's evidence we were satisfied that grey market arbitrage trading in Nokia phones was not likely to take place due to the identical wholesale prices set in European markets. The repeated lengthy deal chains did not keep profitability at reasonable levels for the participants in the chains and the average mark-up made by Waterfire was unusual. The market share levels achieved by Waterfire in 73 instances were implausible and the descriptions on Waterfire's paperwork were in inadequate. We concluded that although most of the features of trading identified by Mr Fletcher went to the existence of a fraud rather than the Appellant's knowledge in it, others, such as the implausibility of the market share traded by the Appellant, raised questions in respect of which we were left with no answers.

371. We attached minimal weight to the statements of Mr Butt which had not been tested by cross-examination and which we treated as documentary hearsay. We considered the issue of what Mr Butt knew was a straightforward factual issue and one which we would have expected him to give evidence about. We did not find the

reasons given for Mr Butt's failure to give evidence credible; we were wholly satisfied that HMRC's case against him had been fully and clearly set out and whilst we bore in mind that aspects of HMRC's case were outside of Mr Butt's direct knowledge, other aspects were not and were clearly matters which called for explanations. The hypothetical reasons for Waterfire's manner of trading put forward by Counsel for Mr Butt were therefore left unsupported by evidence. In the absence of oral evidence we had no explanation regarding the alleged discrepancies and features of trading highlighted by HMRC as unusual and lacking commerciality. These were matters which we considered the Appellant might reasonably have been expected to address in his oral evidence. We did not draw the adverse inference that the Appellant's silence reflected his guilt; had we done so (having satisfied ourselves that HMRC had established a prima facie case) we considered that such an inference would serve only to strengthen the conclusion already reached.

The statutory criteria

372. We applied our conclusions on the legal principles and our assessment of the evidence to the statutory criteria. In doing so, we adopted the following approach:

(i) Did Waterfire do an act for the purpose of evading VAT, including obtaining a VAT credit in circumstances where Waterfire was not entitled to that sum?

(ii) Did the conduct in doing that act involve dishonesty?

(iii) If (i) and (ii) are answered in the positive Waterfire is liable to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by Waterfire's conduct;

(iv) Was the conduct giving rise to that penalty, in whole or in part, attributable to the dishonesty of the Appellant?

(v) What is the amount of the VAT evaded or sought to be evaded and should it be reduced?

<u>(i) Did Waterfire do an act for the purpose of evading VAT, including obtaining a VAT credit in circumstances where Waterfire was not entitled to that sum?</u>

373. It is the case for HMRC that Waterfire's transactions in respect of which it claimed and was denied input tax credit in 04/06 were connected with the fraudulent evasion of VAT and that the Appellant was aware of that fact. HMRC contended that by entering into transactions which the Appellant knew to be connected with the fraudulent evasion of VAT and part of an overall scheme and by making VAT returns which included those transactions Waterfire had done an act for the purpose of evading VAT.

374. The evidence of the HMRC officers in respect of the defaulting traders was not challenged nor was the connection between the Appellant's transactions and the respective tax losses. We were satisfied that the evidence was reliable and that the chains of supply had been accurately traced back to defaulting, missing or hijacked traders such that each of Waterfire's buffer and broker transactions in 04/06 and 07/06 were connected to the fraudulent evasion of VAT, either directly or through contra-trading. Where there was insufficient information to trace the chain of supply we had

to determine whether it was reasonable to infer that acquisitions came from the same source. We took the view that the inference is not just reasonable, but compelling; in a legitimate transaction there would be no reason for a buffer to conceal its source and we were satisfied that the fact that HMRC was unable to trace the chain in its entirety speaks for itself and clearly indicates that the trader deliberately acted as a blocking trader by failing to provide records to HMRC and thereby prevent it from tracing the chain.

375. We were satisfied that Epinx acted as a fraudulent contra-trader in the 5 broker transactions involving Waterfire in period 04/06. On the evidence before us we concluded without hesitation that the transactions involving Epinx were deliberately designed to enable it to balance its VAT account and to generate a significant repayment claim by Waterfire which would not trace directly to a tax loss.

376. As to the issue of knowledge we were satisfied that Waterfire, through its directors, knew that its transactions were connected with fraud. We found that the evidence demonstrated that the Appellant was aware of the nature and prevalence of fraud in the industry, not least as a result of contact between HMRC and Waterfire when such matters were discussed. Taken together with HMRC's published Public Notices and the previous experience of Waterfire's directors in the industry we concluded that Waterfire was well aware of the risk of MTIC fraud.

377. There clearly was, at the relevant time, a genuine grey wholesale market in mobile phones and it is of course entirely possible for a trader who is aware of fraud generally to be unwittingly caught up in it. However when we considered the features of Waterfire's transactions the inescapable conclusion we reached was that Waterfire was not engaged in the genuine grey market, its transactions were wholly artificial and entered into in order to benefit from the fraud. We accepted that the various features of trade highlighted by HMRC lacked commerciality or credibility. We found that some features demonstrated the artificial nature of the transactions and knowledge more than others but viewed cumulatively we concluded that the Appellant must have known of the connection with fraud.

378. We found that the VAT1 signed by Mr Butt was misleading. The VAT1 declared that Waterfire intended to trade in white goods and retail of goods. We inferred that there had never been any such intention. Not only did the company never trade in such goods nor was it a retailer, but inconsistencies in what was said led us to conclude that the declaration was deliberately misleading; Mr Butt was asked in interview why trading in mobile phones was not declared on the VAT1 to which he replied *"no reason"* which we found was at odds with his subsequent explanation that it had been the original intention which did not come to fruition. The anticipated turnover declared on the VAT1 was also far removed from the actual turnover and, in the absence of any explanation as to how the estimated figure was reached and far exceeded, we were satisfied that the information provided was, at the very least without any basis and therefore deliberately misleading. There was also no explanation from the Appellant as to why the letter from Borders VAT Services Ltd dated 28 July 2004 had been annotated by Mr Butt next to the author's question *"who completed the VAT 1, did they know enough about your business?"* read *"Accountant/didn't have enough knowledge"* when in fact it was Mr Butt who had signed the VAT1. We noted that Borders had told HMRC in a telephone call prior to the pre-registration visit that the company was *"importing mobile phones and selling wholesale retail"*. However we were concerned with the knowledge and actions of the

Appellant and our view of the evidence was that it indicated an attempt to mislead HMRC and we inferred that the only explanation for doing so was to avoid HMRC's vetting processes of mobile phone traders seeking VAT registration.

379. We found that the commercial checks undertaken by Waterfire on its trading partners were superficial and inadequate; there was no evidence to show that the Appellant acted on information provided. We noted Mr Butt's assertion that documentation had been either stolen or retained by solicitors; however we were left with an assertion by Mr Butt that due diligence was robust and thorough which was unsupported by oral evidence, untested by cross-examination and to which we attached no weight.

380. We did not consider the back-to-back nature of the transactions indicative of the Appellant's knowledge of fraud nor did we consider that Waterfire's use of an FCIB account supported the allegation that it knew the movement of funds was orchestrated.

381. We found the limited evidence of price negotiation unusual. In our view the any reasonable trader conducting legitimate transactions of such high value would have a record, such as emails, covering discussions regarding price, payment or shipping. There were no clear written terms pertaining to issues such as redress. We found it implausible that the Waterfire chose to operate with such a remarkable lack of clear documentation in respect of its transactions and even taking into account the Appellant's explanation that documents were stolen, we were left without any oral evidence either explaining how Waterfire operated or why information such as emails did not exist and could not be retrieved. In our view this was implausible for a legitimate trader seeking to minimise exposure to risk and we found it indicative of the Waterfire's knowledge through its directors that the trading was contrived.

382. We noted that Waterfire continued to trade with Gee-Tec and International Electrical Distributors Ltd after it was informed that its transactions with those companies had been traced back to tax losses. We were left without any explanation for this. We were satisfied that any legitimate trader dealing in consignments worth hundreds of thousands of pounds would have taken steps to either investigate the matter thoroughly or simply conduct no further transactions with the trader in question; that the Appellant did not do so was, in our view, indicative of his knowledge that the transactions were artificially contrived and connected with fraud.

383. We noted the inconsistency in the evidence before us regarding IMEI numbers; initially Waterfire had notified HMRC that it intended to implement an IMEI verification system and provided details as to the company said to be developing the system. The reason subsequently put forward for Waterfire's refusal to obtain IMEI numbers was cost. We had no explanation or detail as to what that cost was, the consideration given to it or what happened to the company said to be developing the system. Waterfire's refusal to obtain IMEI numbers was not, in our view, consistent with a legitimate trader seeking to protect itself from connection with fraud and we found that this evidence supported HMRC's case that Waterfire knew that the transactions were connected with fraud.

384. We found the inspections commissioned by Waterfire, when viewed against the value of the transactions, were wholly inadequate. Given the reliance placed on inspections by the Appellant in circumstances where it never physically took

possession of the goods and bearing in mind the limited specification of the goods contained on the documentation we concluded that this feature of Waterfire's trading indicated knowledge that its deals formed part of a fraudulent scheme and therefore, in reality, the inspections were immaterial.

385. The directors of Waterfire provided inconsistent accounts as to whether the goods were insured and by whom. No documentary evidence was ever produced to HMRC to support the assertions and taking into account the significant value of the transactions we concluded that this was another feature that indicated knowledge of the fraud by Waterfire.

386. We found the significant growth in Waterfire's turnover did not resemble that of an ordinary business over such a short period of time. Waterfire achieved a turnover of £17,130,164 in the first year of trading which then increased dramatically to £168,843,683 in the year ending 2006. We were provided with no explanation for this and there was no evidence before us to demonstrate that the Appellant had questioned such success, which on any view would on the face of it appear too good to be true. We also considered this issue in the context of the Waterfire's remarkable ability to match its inputs and outputs almost exactly with apparent ease; for instance the cancelled deal on 21 April 2006 where goods were re-sold on the same date at the same price which had the consequence that Waterfire's VAT liability for the period was £2,942.50 as opposed to £152,501.88. We were satisfied that Waterfire, through its directors, was fully aware that its dealt formed part of the scheme to defraud.

387. HMRC alleged, and we were satisfied that the Appellant acted as a contra-trader in the period with which we are concerned. We accepted the submission on behalf of the Appellant that there is nothing inherently wrong or unlawful with contra-trading and that a trader may legitimately arrange his trading in such a way for cash flow purposes. However for the reasons we have set out we were satisfied that there were no legitimate reasons for the manner of Waterfire's trading. A contra-trader offsets input tax it would otherwise re-claim following a broker transaction in the dirty chain against output tax it would pay following an acquisition in the clean chain; as a result any repayment claim is small. The broker who makes a large repayment claim appears to be in a clean chain unconnected with fraud as the defaulter in the dirty chain is concealed by the contra-trader. Furthermore, both chains (and the role of the contra-trader in connecting the chains) are important parts of the fraud. We concluded that Waterfire's actions as a contra-trader and the transactions it undertook were fully intended to facilitate fraud by concealing the dirty chains and thereby assisting brokers in chains seemingly not connected to fraud to make and receive large repayments.

Having considered all of the evidence before us, we concluded that the Appellant had actual knowledge that the transactions of Waterfire were connected to the fraudulent evasion of VAT. Our conclusion was therefore that by entering into those transactions, acting as a contra-trader and making VAT returns which included those artificially contrived transactions, we were satisfied that Waterfire had done an act for the purpose of evading VAT. We were also satisfied that Waterfire did so in circumstances where it was not entitled to the sum claimed as it had no right to deduct, that right having been lost as the transactions fell outwith the scope of VAT by their fraudulent nature and Waterfire's actual knowledge of that fraud.

(ii) Did the conduct in doing that act involve dishonesty?

388. The *Ghosh* test for assessing dishonesty comprises an objective test and the second stage a subjective test. In applying that test we concluded that, according to the ordinary standards of reasonable and honest people, Waterfire's acts committed for the purpose of obtaining a VAT credit to which it was not entitled were wholly and obviously dishonest. As to the subjective element, we rejected the submission made on behalf of the Appellant that Waterfire held an honest and genuine belief of entitlement to VAT repayment. There was no oral evidence from Mr Butt on the issue and we could only conclude that Waterfire, through its directors, must have known that its actions were, by ordinary standards, dishonest. As Waterfire was dishonest it follows that its directors who caused Waterfire to behave dishonestly were also dishonest.

389. We rejected the Appellant's submission that an awareness of a connection with fraud is not sufficient to satisfy the legislation and we adopt the words of Briggs J in *Megtian* at 21 – 25 in support of our conclusion:

"It is important to bear in mind, although the phrase "knew or ought to have known" slips easily off the tongue, that when applied for the purpose of identifying the state of mind of a person who has participated in a transaction which is in fact connected with a fraud, it encompasses two very different states of mind. A person who knows that a transaction in which he participates is connected with fraudulent tax evasion is a participant in that fraud. That person has a dishonest state of mind. By contrast, a person who merely ought to have known of the relevant connection is not dishonest, but has a state of mind broadly equivalent to negligence."

390. We noted the inconsistencies and anomalies in the financial information provided by the Appellant regarding loans and payments. No response was received to HMRC's request for further details and we were left without any explanation as to why it would appear that the Appellant lied to HMRC, for instance having told HMRC on 21 June 2006 that the company had no outstanding loans a payment is shown from Waterfire's HSBC account on 10 August 2006 in the sum of £200,000 which is described as "Return of Loan – Umaad Butt". Furthermore evidence produced during the substantive hearing showed that payments in excess of £1,000,000 had been made to the Appellant which contradicted earlier assertions and led us to conclude that the Appellant had been deliberately dishonest in respect of financial matters.

391. In addition to the reasons set out at above, we also took into account Waterfire's failure to pay or account for corporation tax for the years to 30 April 2006 and 30 April 2007, the apparent under-declaration of profits on that return when compared to the records of sales and purchases, the inaccurate accounts for the year ending 30 April 2006 which were signed by Mr Royle on 13 April 2009 when the Appellant was still a director and the transaction undertaken in 01/06 by Waterfire (UK) Ltd, in which Waterfire (the customer) claimed the deduction of input tax but Waterfire (UK) Ltd did not account for or pay the output tax. No explanation has been provided by the Appellant for these matters. We concluded that although not specific to the fraud and dishonesty with which we are concerned these surrounding circumstances, when viewed in the overall context of Waterfire's actions and manner of trading, reinforced our finding of dishonesty.

(iii) If (i) and (ii) are answered in the positive Waterfire is liable to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by Waterfire's conduct;

392. As a result of our findings of facts and conclusions thereon we were satisfied that Waterfire is liable to a penalty equal to the amount sought to be evaded by it's conduct pursuant to section 60 VATA 1994.

(iv) Was the conduct giving rise to that penalty, in whole or in part, attributable to the dishonesty of the Appellant?

393. Our conclusion in respect of dishonesty and reasons are set out above. We were satisfied that Waterfire, through the Appellant as a director, was carrying out transactions and acting as a contra-trader for the purposes of a scheme to defraud the revenue. We were therefore satisfied that the conduct of Waterfire which gave rise to the penalty was wholly attributable to the dishonesty of the Appellant and his co-director.

(v) What is the amount of the VAT evaded or sought to be evaded and should it be reduced?

394. By virtue of section 60 (2) (b) VATA 1994 evading VAT includes obtaining a VAT credit in circumstances where the person is not entitled to that sum. Section 60 (3) of the Act provides that a reference to VAT sought to be evaded in relation to a VAT credit shall be construed as a reference to the aggregate of the amount falsely claimed by way of credit for input tax and the amount by which output tax was falsely understated. The VAT sought to be evaded was the amount of the input tax credit claimed by Waterfire in its VAT return for period 04/06 of £6,972,184.00.

395. A penalty in the sum of £3,137,483.03 was imposed on Mr Tahir pursuant to section 61 VATA 1994. A penalty in the same amount was imposed on the Appellant. We followed the guidance in *Han and Others* in which the Court of Appeal said:

"…The function of civil penalties is not compensatory. They are imposed in addition to the assessed liability for tax and the interest recoverable therein…the function of the penalties is one of punishment and deterrence vis the individual and general deterrence so far as taxpayers at large are concerned."

In doing so we were satisfied that the penalty imposed was proportionate and it would not be proper to reduce it.

Conclusion

396. We have had regard to a significant amount of oral and documentary evidence. We do not refer to all the evidence in this decision, but only that which is necessary to understand our findings of fact and conclusions in relation to contentious issues.

397. We were satisfied that the statutory criteria by virtue of which the penalty was imposed on the Appellant was satisfied. In reaching our conclusion on the issues of the Appellant's knowledge and dishonesty we note that some reasons carried more weight than others and we did not base our decision solely on one reason but rather the cumulative effect of our findings viewed in totality.

398. In so far as the Appellant invited us to refer matters of EU law to the CJEU, in our judgment the answers were acte clair.

399. The appeal is dismissed.

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

TRIBUNAL JUDGE
RELEASE DATE:

APPENDIX A: SUMMARY JUDGMENT DECISION

Appeal number: TC/2010/06495 & TC/2010/06596

SUMMARY JUDGMENT – Application by Appellant in respect of an appeal against a penalty issued under section 61 VATA 1994 – whether Respondent's case has no reasonable prospect of succeeding – application refused.

FIRST-TIER TRIBUNAL
TAX CHAMBER

UMAAD BUTT **Appellant**

- and -

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

TRIBUNAL: JUDGE JENNIFER BLEWITT

Sitting in public at Manchester on 14 May 2014

Mr Rory Mullen leading Ms Harriet Brown, Counsel for the Appellant

Mr Jeremy Benson QC leading Ms Karen Robinson, Counsel instructed by HM Revenue and Customs, for the Respondents

© CROWN COPYRIGHT 2014

DECISION

Introduction

401. This is an application made by the Appellant for summary judgment against HMRC in respect of a penalty issued on 29 March 2010 under section 61 Value Added Tax Act ("VATA") 1994.

402. Prior to the hearing I was provided with the Appellant's written application dated 17 December 2013 and skeleton argument dated 6 May 2014. HMRC provided a written response to the application dated 17 January 2014 and skeleton argument received on 12 May 2014. I was also provided with 4 bundles containing, in the main, the relevant legislation and authorities.

The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Rules")

403. Rule 8 (3) (c) provides that the Tribunal may strike out *"the whole or a part of the proceedings if…the Tribunal considers there is no reasonable prospect of the appellant's case, or part of it, succeeding."*

404. Under Rule 8 (7) the Tribunal's powers under Rule 8 (3) apply to the respondent as it applies to an appellant, save that *"a reference to the striking out of the proceedings must be read as a reference to the barring of the respondent from taking further part in the proceedings."*

405. Rule 8 (8) provides as follows:

"If a respondent has been barred from taking further part in proceedings under this rule and that bar has not been lifted, the Tribunal need not consider any response or other submissions made by that respondent, and may summarily determine any or all issues against that respondent."

Background Facts

406. The Statement of Case dated 6 May 2011 sets out in detail the background to the disputed decision, the legislation applicable and issues in the case. In essence HMRC imposed a penalty on the Appellant on 29 March 2010 pursuant to section 61 VATA 1994. The penalty was imposed by reference to the Appellant's conduct as a director of Waterfire Ltd ("Waterfire") which HMRC allege rendered itself liable to a penalty pursuant to section 60 (1) VATA 1994 on the basis that it had entered into various transactions and rendered VAT returns for the purpose of evading VAT. In particular the company made claims to input tax credit when it knew that the underlying transactions were connected with fraud, thereby seeking to evade £6,972,184 in VAT period 04/06. HMRC contend that the conduct giving rise to Waterfire's liability to a penalty was wholly, or in part attributable to the conduct of Mr Butt as a director and 50% shareholder of the company.

407. HMRC allege that Waterfire, through Mr Butt as a director, deliberately and artificially constructed its trading in such a way as to enable what would otherwise give rise to large claims for repayment from HMRC to be offset and made by other

companies acting as brokers. It is contended that Waterfire knowingly acted as a contra trader in VAT periods 04/06 and 07/06 as part of a scheme to defraud the public revenue.

408. The issues identified by HMRC as those to be determined by the Tribunal at the substantive hearing which is listed for 16 to 27 June 2014 can be summarised as follows:

(i) Whether the transactions entered into by Waterfire in 04/06 and 07/06 were part of an overall scheme to defraud the public revenue;

(ii) Whether Waterfire, through the Appellant, knew that its transactions were connected to fraud;

(iii) Whether, by entering into its transactions in period 04/06 and making its VAT return for that period on the basis of those transactions, Waterfire was doing acts for the purpose of evading VAT;

(iv) Whether Waterfire, through the Appellant, knew that its transactions in period 04/06 were connected with fraud and its conduct was thereby dishonest;

(v) Whether, in the circumstances set out at 8 (i) – (iv) above, Waterfire was liable to a penalty pursuant to section 60 VATA 1994;

(vi) Whether the VAT sought to be evaded by Waterfire was the amount of the input tax credit claimed by it in its VAT return for 04/06, namely £6,972,184;

(vii) Whether the conduct of Waterfire was wholly or in part attributable to the dishonesty of the Appellant; and

(viii) Whether the quantum of the penalty should be reduced.

Legislation

409. Section 60 VATA 1994 provides as follows:

(1) In any case where-

(a) for the purpose of evading VAT, a person does any act or omits to take any action, and
(b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability),

he shall be liable, subject to subsection (6) below, to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by his conduct.

(2) The reference in subsection (1)(a) above to evading VAT includes a reference to obtaining any of the following sums-

(a) a refund under any regulations made by virtue of section 13(5);
(b) a VAT credit;

(c) a refund under section 35, 36 or 40 of this Act or section 22 of the 1983 Act; and
(d) a repayment under section 39,

in circumstances where the person concerned is not entitled to that sum.

(3) The reference in subsection (1) above to the amount of the VAT evaded or sought to be evaded by a person's conduct shall be construed-

(a) in relation to VAT itself or a VAT credit as a reference to the aggregate of the amount (if any) falsely claimed by way of credit for input tax and the amount (if any) by which output tax was falsely understated; and

(b) in relation to the sums referred to in subsection (2)(a), (c) and (e) above, as a reference to the amount falsely claimed by way of refund or repayment.

(4) Statements made or documents produced by or on behalf of a person shall not be inadmissible in any such proceedings as are mentioned in subsection (5) below by reason only that it has been drawn to his attention-

(a) that, in relation to VAT, the Commissioners may assess an amount due by way of a civil penalty instead of instituting criminal proceedings and, though no undertaking can be given as to whether the Commissioners will make such an assessment in the case of any person, it is their practice to be influenced by the fact that a person has made a full confession of any dishonest conduct to which he has been a party and has given full facilities for investigation, and

(b) that the Commissioners or, on appeal, a tribunal have power under section 70 to reduce a penalty under this section,

and that he was or may have been induced thereby to make the statements or produce the documents.

(5) The proceedings mentioned in subsection (4) above are-

(a) any criminal proceedings against the person concerned in respect of any offence in connection with or in relation to VAT, and
(b) any proceedings against him for the recovery of any sum due from him in connection with or in relation to VAT.

(6) Where, by reason of conduct falling within subsection (1) above, a person is convicted of an offence (whether under this Act or otherwise), that conduct shall not also give rise to liability to a penalty under this section.

(7) On an appeal against an assessment to a penalty under this section, the burden of proof as to the matters specified in subsection (1)(a) and (b) above shall lie upon the Commissioners.

410. Section 61 VATA 1994 provides as follows:

(1) Where it appears to the Commissioners-

(a) that a body corporate is liable to a penalty under section 60, and

(b) that the conduct giving rise to that penalty is, in whole or in part, attributable to the dishonesty of a person who is, or at the material time was, a director or managing officer of the body corporate (a "named officer"),

the Commissioners may serve a notice under this section on the body corporate and on the named officer.

(2) A notice under this section shall state-

(a) the amount of the penalty referred to in subsection (1)(a) above ("the basic penalty"), and
(b) that the Commissioners propose, in accordance with this section, to recover from the named officer such portion (which may be the whole) of the basic penalty as is specified in the notice.

(3) Where a notice is served under this section, the portion of the basic penalty specified in the notice shall be recoverable from the named officer as if he were personally liable under section 60 to a penalty which corresponds to that portion; and the amount of that penalty may be assessed and notified to him accordingly under section 76.

(4) Where a notice is served under this section-

(a) the amount which, under section 76, may be assessed as the amount due by way of penalty from the body corporate shall be only so much (if any) of the basic penalty as is not assessed on and notified to a named officer by virtue of subsection (3) above; and
(b) the body corporate shall be treated as discharged from liability for so much of the basic penalty as is so assessed and notified.

(5) No appeal shall lie against a notice under this section as such but—

(a) where a body corporate is assessed as mentioned in subsection (4)(a) above, the body corporate may appeal against the Commissioners' decision as to its liability to a penalty and against the amount of the basic penalty as if it were specified in the assessment; and
(b) where an assessment is made on a named officer by virtue of subsection (3) above, the named officer may appeal against the Commissioners' decision that the conduct of the body corporate referred to in subsection (1)(b) above is, in whole or part, attributable to his dishonesty and against their decision as to the portion of the of the penalty which the Commissioners propose to recover from him.

(6) In this section a "managing officer", in relation to a body corporate, means any manager, secretary or other similar officer of the body corporate or any person purporting to act in any such capacity or as a director; and where the affairs of a body corporate are managed by its members, this section shall apply in relation to the conduct of a member in connection with his functions of management as if he were a director of the body corporate.

Submissions on behalf of the Appellant

411. Mr Mullen submits that HMRC have no legal basis for imposing the penalty which is the subject of the appeal and that the Tribunal should summarily determine the appeal in favour of the Appellant as HMRC's case has no reasonable prospect of success.

412. The issues can be categorised as follows:

(i) As a matter of construction and interpretation of VATA 1994 did HMRC have power to issue a penalty under section 61 on the basis of the facts alleged in the Statement of Case (which are not accepted); and

(ii) If there was, prima facie, power to issue the penalty, was that power restricted by human rights legislation under the relevant provisions of the ECHR and EU Charter.

413. As to the first issue, namely whether HMRC had the power to impose a penalty under section 61 VATA 1994 Mr Mullen submits that no such power existed for the following reasons:

- Waterfire did not evade VAT within the meaning of section 60 VATA 1994;
- Waterfire and/or the Appellant cannot be regarded as having been dishonest in making a claim for repayment of VAT on supplies which were genuinely made to Waterfire. Participation in a wider VAT fraud is irrelevant to that issue;
- There was no VAT falsely claimed; and
- Legislation is required to enable a penalty to be imposed in the circumstances set out in HMRC's Statement of Case.

414. As regards whether any such power, if found to exist, was restricted by the ECHR and EU Charter Mr Mullen submits that:

- The scope of the penalty was widened by case law that postdates the events which are said to give rise to the penalty. Imposition of a penalty is therefore in breach of the prohibition on retrospective criminalisation;
- The refusal of the right to deduct has been classified as a penalty by the CJEU and therefore the imposition of a further penalty would be in breach of Article 50 of the EU Charter; and
- The penalty is in any event disproportionate.

415. It was clarified by Mr Mullen that although the facts set out in HMRC's Statement of Case are not accepted, this application can be determined on the basis of legal submissions made were the facts alleged proved.

The Penalty Provisions

416. In order for Waterfire to be liable to a penalty under section 60 VATA 1994 it must be shown that:

- Waterfire intended to evade VAT;
- It did so dishonestly; and
- An amount of input tax was falsely claimed.

417. Mr Mullen submits that HMRC's case is based on the premise that Waterfire was not entitled to claim input tax in respect of supplies made by it in the period from 1 February 2006 to 31 July 2006 as a result of the decision by the CJEU in *Kittel v Belgium, Belgium v Recolta Recycling* [2008] STC 1537*("Kittel")* and the Court of Appeal in *Mobilx Ltd v HMRC ("Mobilx")* [2010] EWCA Civ 517. He contends that the Statement of Case appears inconsistent with the skeleton argument which extended the scope of HMRC's case against the Appellant such that it remains unclear what the case to be met is. Mr Mullen also notes that the Statement of Case is replete with terminology said to derive from case law without any explanation of what the terminology means, although no specific examples were given.

418. The only basis upon which HMRC can show that Waterfire was not entitled to an input tax credit is by reference to *Kittel* and *Mobilx*. Without any such reference it cannot be said that Waterfire was not entitled to an input tax credit and the statutory requirements of section 61 VATA 1994 would not be met.

419. Mr Mullen contends that MTIC case law forms an important part of the background to this appeal as HMRC must rely on it as the foundation for the imposition of the penalty under appeal. Without the cases there can be no question of a penalty. In those circumstances it is relevant to consider the development of the law in this area and the dates upon which judgments were handed down. The fact that the transactions entered into by Waterfire were conducted in the context of the law as it was understood at the time is relevant to the issue of dishonesty. Mr Mullen contends that it cannot be dishonest to do an act which was understood to be legal at the time. The development of the law is also relevant to the issue of whether the penalty amounts to retrospective criminalisation.

420. Section 26 VATA 1994 concerns the right to deduct input tax:

(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business-

(a) taxable supplies;
(b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;
(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection.

421. Prima facie the Appellant had a right under section 26 VATA 1994 to claim input tax. It must therefore follow that the claim was not falsely made.

422. Mr Mullen outlined the increasing scope of MTIC fraud which led to the introduction of joint and several liability legislation, the requirement for security and reverse charge provisions. On 12 January 2006 the CJEU handed down its judgment in *Optigen Ltd and Fulcrum Trading Co (UK) Ltd* (VATD 18113) in which the Court concluded:

"... transactions such as those at issue in the main proceedings, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity ... where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge. The right to deduct input VAT of a taxable person who carries out such transactions cannot be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing".

423. Mr Mullen argues that this represented a new development in the law at the relevant time, the scope of which was unclear as was the issue of how it interacted with domestic law.

424. On 14 March 2006 the Advocate-General gave his opinion in *Kittel* and the judgment of the CJEU was given on 6 July 2006. At paragraph 59 the Court stated:

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

425. Mr Mullen submits that the Appellant could not have been expected to know the position under EU law at the date of the relevant claim.

426. Furthermore Mr Mullen submits that HMRC cannot rely on *Kittel* and *Mobilx* which had no direct or binding effect as a matter of UK law. In order to rely on the *Kittel* jurisprudence it is necessary to construe the right to reclaim input tax in section 26 VATA 1994 as limited in circumstances where a supply is connected with fraud. The wording of the statute is clear and there is no suggestion that any such limitation can be read in to it. It could not have been clear that *Kittel* had any consequence for UK taxpayers.

427. Mr Mullen acknowledges that Moses LJ rejected in *Mobilx* (at paragraphs 46 – 49) the argument that *Kittel* could not be applied as part of UK domestic law without specific legislation:

"A*ccordingly, the objective criteria which form the basis of concepts used in the Sixth Directive form the basis of the concepts which limit the scope of VAT and the right to deduct under ss. 1, 4 and 24 of the 1994 Act. Applying the principle in Kittel, the*

objective criteria are not met where a taxable person knew or should have known that by his purchase he was participating in a transaction connected with fraudulent evasion of VAT. That principle merely requires consideration of whether the objective criteria relevant to those provisions of the VAT Act 1994 are met. It does not require the introduction of any further domestic legislation...

It is the obligation of domestic courts to interpret the VATA 1994 in the light of the wording and purpose of the Sixth Directive as understood by the ECJ (Marleasing SA 1990 ECR 1-4135 [1992] 1 CMLR 305) (see, for a full discussion of this obligation, the judgment of Arden LJ in Revenue and Customs Commissioners v IDT Card Services Ireland Limited [2006] EWCA Civ 29 [2006] STC 1252, §§ 69-83). Arden LJ acknowledges, as the ECJ has itself recognised, that the application of the Marleasing principle may result in the imposition of a civil liability where such a liability would not otherwise have been imposed under domestic law (see IDT § 111). The denial of the right to deduct in this case stems from principles which apply throughout the Community in respect of what is said to be reliance on Community law for fraudulent ends. It can be no objection to that approach to Community law that in purely domestic circumstances a trader might not be regarded as an accessory to fraud. In a sense, the dichotomy between domestic and Community law, in the circumstances of these appeals, is false. In relation to the right to deduct input tax, Community and domestic law are one and the same.

428. However he submits that the judgment noted the obligation to construe UK legislation in conformity with the Directives to which it gives effect and applied a conforming interpretation whereby the principles in *Kittel* were implied into the UK tax code. Such conforming interpretation is limited to civil liabilities and therefore can have no application to the imposition of a criminal penalty.

Construction of the penalty provisions

429. It is not disputed that the penalty gives rise to “criminal charges” for the purposes of the European Convention on Human Rights (“ECHR”) and the Charter of Fundamental Rights of the European Union (“the EU Charter”) (*Jussila v Finland* [2009] STC 29)

430. On the basis that *Mobilx* was restricted to the consideration of civil as opposed to criminal liability, it cannot be relied upon by HMRC as authority to support the proposition that UK law can be interpreted consistently with *Kittel* such as to permit the imposition of a penalty.

431. HMRC’s approach in this case breaches the principle found in Article 7 of the ECHR which provides that:

“No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the time when it was committed. Nor shall a heavier penalty be imposed than the one that was applicable at the time the criminal offence was committed.”

432. Applying the principles set out in *Mobilx* to section 61 VATA 1994 would widen the scope of an existing offence, contrary to the established principle that courts do not:

"...have some general or residual power either to create new offences or so to widen existing offences as to make punishable conduct of a type hitherto not subject to punishment." (R v Knuller (Publishing, Printing and Promotions) Ltd [1973] AC 435

433. Consequently, absent reliance on *Kittel* and *Mobilx*, there can be no legal basis for the imposition of a penalty and therefore HMRC's case has no reasonable prospect of succeeding.

Meaning of tax evasion

434. Mr Mullen submits that the term *"evasion"* is more limited in scope than the extended definition applied by HMRC to cover a situation whereby input tax is claimed which subsequently proves not to be due. He contends that there are, in effect, three meanings of the word which are used interchangeably by HMRC:

- To "dodge" a liability;
- The statutory meaning within section 60 VATA 1994; and
- Following the principles in Kittel whereby the evasion is via a link to a missing trader.

435. The extension set out in section 60 (2) by reference to a VAT credit is required because a claim for input tax which is falsely made would not fall within the natural meaning of "evasion" which should be read as "dodging a liability" (citing *R v Dealy* [1995] STC 215 in support.) By way of example Mr Mullen submits that the extended meaning would apply in situations whereby a supply took place but VAT was not accounted for or claiming input tax where there was no supply; in both instances the evasion relates to a claim which is plainly false. The term *"evasion"* cannot extend to every situation where VAT credits are claimed, particularly where input tax was incurred. In this case the Appellant did not dodge any liability; to the contrary by making a claim he "put himself in the headlights."

436. In the circumstances of the present appeal it cannot be said that there was evasion of tax for the purposes of section 60 VATA 1994 by Waterfire and it follows that HMRC's case has no reasonable prospect of success.

Dishonest conduct

437. Mr Mullen submits that the dishonesty required by statute must relate to Waterfire's specific conduct whereby it sought to deduct VAT, namely acquiring the supplies and claiming VAT incurred on them. HMRC have wrongly assumed that an awareness of a connection with fraud is sufficient to satisfy the legislation. Mr Mullen disputes that *Megtian,* cited by Mr Benson QC, supports HMRC's case in this regard.

438. Dishonesty in relation to a wider series of transactions (if proved), even if the Appellant could be shown to be fully aware of an MTIC fraud connected to its supplies, is irrelevant for the purposes of section 61 VATA 1994. Mr Mullen contends that if the Appellant was entitled to make a claim to input tax it matters not whether he was dishonest. Mr Mullen argues that there a distinction can be drawn in that the right to make a claim which can be denied is not a false claim but rather a conditional claim.

The amount of VAT falsely claimed

439. As there was nothing in the VAT return or accompanying leaflets which indicated any limitation on Waterfire's right to reclaim VAT, it cannot be said that there was no right to deduct.

440. A false claim is one which has no basis as distinct from a claim which has a legitimate basis but is potentially liable to be refused. Waterfire's claim cannot therefore be said to be false.

Breach of human rights legislation

441. Even if power exists to impose the penalty appealed against, to do so breaches the ECHR and EU Charter.

442. Article 49 of the EU Charter provides:

"*No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national law or international law at the time when it was committed. Nor shall a heavier penalty be imposed than that which was applicable at the time the criminal offence was committed. If, subsequent to the commission of a criminal offence, the law provides for a lighter penalty, that penalty shall be applicable.*

2. This Article shall not prejudice the trial and punishment of any person for any act or omission which, at the time when it was committed, was criminal according to the general principles recognized by the community of nations.

3. The severity of penalties must not be disproportionate to the criminal offence."

443. HMRC's reliance on *Kittel* and *Mobilx,* together with the extended meaning it has given to the term *"evasion"* as the reasons why the Appellant was not entitled to claim input tax is reliance on the widened scope of an existing offence which is prohibited.

444. *Kittel* represented a novel development in the law and provided a new ground upon which a right of deduction could be refused (see *Mobilx* and *Mahagében* Joined Cases C-80/11 and C-142/11 for support). As such the penalty, which is based on that decision, cannot relate to activities which predate *Kittel*. The penalty under appeal was imposed in breach of Article 7 ECHR.

445. Furthermore Article 49 imposes a directly enforceable right that a penalty must not be disproportionate to the offence. Mr Mullen queries the economic benefit said to have been obtained by the Appellant. He submits that the penalty in this appeal in the sum of £3,137,483.03 is manifestly disproportionate and vastly exceeds the amount by which Waterfire could have profited from its transactions or the amount of VAT jeopardised.

Right not to be punished twice

446. Article 50 of the EU Charter provides:

"*No one shall be liable to be tried or punished again in criminal proceedings for an*

offence for which he or she has already been finally acquitted or convicted within the Union in accordance with the law."

447. The refusal of the right to deduct has been described by the CJEU as a penalty on numerous occasions (*Mahageban, LVK* Case C-643/11, *Bonik EOOD* Case C-285/11 and *Evita-K EOOD* Case C-78/12). It is to be assumed that the word was used with a degree of care. A penalty on Waterfire under section 60 VATA 1994 would involve a second penalty for the same conduct and as a lawful penalty on Waterfire is a prerequisite to a penalty on the Appellant it follows that there is no power to lawfully impose a penalty upon the Appellant.

HMRC's Submissions

448. HMRC's position can be summarised as follows:

- The Appellant's repeated assertion that the penalty imposed upon him pursuant to *Section 61* of the *Value Added Tax Act 1994* was imposed by reference to the *Kittel* decision and subsequent case-law, or the input tax claimed by Waterfire Ltd which was disallowed, fundamentally misunderstands the nature of, and basis for, the penalty;

- The basis for the decision to penalize the Appellant was not the fact that Waterfire Ltd had been denied its entitlement to claim input tax credit in accordance with *Kittel* principles; rather, the basis for the penalty is the fulfillment of the statutory criteria set out within *Section 61(1)* of the *Value Added Tax Act 1994*;

- Waterfire Ltd rendered itself liable to a penalty on the basis that it had entered into various transactions, and rendered VAT returns including those transactions, for the purpose of evading VAT. The transactions entered into by by Waterfire were themselves fraudulent (including its actions as a contra-trader) having been entered into "for the purposes of evading VAT", they were connected to a tax loss which was known to Waterfire and it was therefore a knowing and dishonest participant of a fraudulent scheme to defraud the Revenue. The conduct giving rise to Waterfire Ltd's liability to a penalty was wholly or partly attributable to the conduct of the Appellant;

- A taxpayer who actively and knowingly participates in a fraudulent scheme and makes a VAT return based upon his transactions loses his right to deduct, and any claim to input tax credit based upon such transactions must be false;

- It has long been established by the CJEU that the objective criteria for identifying supply of goods or services and economic activity are not met where tax is evaded by the taxable person himself;

- The imposition of a penalty under section 60 (1) VATA 1994 gives rise to "criminal charges" within the meaning of Article 6 (1) of the ECHR (*Han and Yau v HMCE* [2001] 1 WLR 2253, CA);

- The classification of the provisions of section 60 (1) VATA 1994 is a classification for the purposes of the ECHR only such that Article 7 applies to

the statutory provision;

- The penalty does not breach the provisions of Articles 6 or 7 of the ECHR;

- Both section 60 and 61 of VATA 1994 were in force at the time of the transactions in question. Therefore the law at the relevant time was clear and the issue of retrospective punishment does not arise;

- The requirements of section 61 (1) VATA 1994 are met;

- The input tax claim in the circumstances alleged by the Respondents may properly be considered evasion, consistent with the statutory provisions;

- The refusal of the right to deduct input tax is not a penalty; rather it is the loss of a right, such that any penalty imposed pursuant to *Section 60* of the *Value Added Tax Act 1994* does not breach the provisions of the EU Charter;

- The quantum of the penalty is proportionate because the civil penalty scheme (which allows for exposure of the taxable person to a penalty in the maximum sum of 100% of the tax alleged to have been evaded or sought to have been evaded) is a just balance between the legitimate interests of HMRC and the taxpayer.

The Penalty Provisions

449. On behalf of HMRC Mr Benson QC submits that the penalty appealed against was not imposed by reference to the input tax disallowed or the case law in *Kittel* and *Mobilx* but rather by reference to the VAT evaded or sought to have been evaded.

450. A finding that the imposition of a penalty gives rise to a criminal charge is the threshold condition for application of the substantive provisions of Article 6 to the civil penalty procedures under section 60 VATA 1994. The concept of "criminal charge" under Article 6 has an "autonomous" Convention meaning. Three criteria are applied by the Strasbourg Court to determine whether a criminal charge has been imposed (*AP v Switzerland* (1998) 26 EHRR 541):

- The classification of the proceedings in domestic law;

- The nature of the offence; and

- The nature and degree of severity of the penalty that the person concerned risked incurring.

Development of the Refusal of the Right to Deduct

451. The prevention of tax evasion, avoidance and abuse has always been an objective recognised and encouraged by the Sixth Directive. Where the right to deduct has been exercised fraudulently, the tax authorities have always had the authority to claim repayment of the deducted sums retroactively or refuse the right to deduct. Pre-*Kittel* there were a number of authorities which supported the principle that the Sixth Directive must be interpreted as precluding any right of a taxable person to deduct

input VAT where the transactions from which the right derives constitute an abusive practice.

452. *Kittel* developed a principle already long established in CJEU jurisprudence (referred to at paragraph 55 of the judgment) to include the 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. The development related to the issue of constructive knowledge of a taxable person as opposed to actual knowledge.

453. In *Halifax and others* [2006] ECR I/1609 the Court emphasised that the objective criteria which form the basis of the entitlement to deduct input tax are not satisfied where tax is evaded:

"It is true that those criteria are not satisfied where tax is evaded, for example by means of untruthful tax returns or the issue of improper invoices..."

454. In *Mobilx* Moses LJ held that the principles in *Kittel* could be applied as part of UK domestic law without the introduction of further UK legislation. In response to the Appellant's contention that this conforming interpretation by the Court of Appeal was limited to civil liabilities, HMRC submits that the Appellant has misunderstood the nature of and basis for the penalty imposed on the Appellant which derives from statute.

Meaning of "Evasion"

455. The Appellant's reliance on *R v Dealy* provides little assistance as the Court of Appeal in that case was asked to provide a definition of "evasion" in section 39 VATA 1983 in a particular factual context which is distinguishable from the circumstances of the Appellant's case.

456. Evading VAT, or seeking to do so, can include obtaining or seeking to obtain a VAT credit where the person concerned is not entitled to that sum. In this case the Appellant's attempt to obtain input tax in respect of transactions which were and which the Appellant knew to be connected with fraud is an act for the purpose of evading VAT and amounts to a false claim for input tax credit. Such an interpretation is consistent with the statutory criteria set out in section 60 VATA 1994.

Dishonest Conduct

457. The dishonest conduct alleged is that Waterfire knowingly entered into transactions, which were fraudulent in nature and formed part of a scheme to defraud the Revenue, and rendered VAT returns which included those transactions. (See *Megtian Ltd (In Administration) v HMRC* [2010] EWHC 18 (Ch)).

Right not to be punished twice

458. Mr Benson QC submits that the refusal of the right to deduct cannot properly be regarded as a penalty such that any penalty subsequently imposed upon Waterfire pursuant to section 60 VATA 1994 cannot be regarded as a "second penalty".

459. The description of the refusal of the right to deduct as a penalty in *Mahagében* does not accord with the description applied earlier in the same authority (at paragraph 45) nor descriptions elsewhere. By way of example Mr Benson QC cited

Mobilx (at paragraphs 64 and 65) in which Moses LJ considered this specific issue and concluded that the loss of the right to deduct cannot properly be considered a penalty. On that basis the penalty imposed cannot be said to have been imposed in addition to an earlier penalty.

460. Furthermore the right to deduct was denied to the company Waterfire and the penalty was imposed on the Appellant; two separate legal entities.

Proportionality

461. HMRC submit that, if the allegations are proved, the penalty is proportionate. I was referred to *Han and others v C&E Commissioners* [2001] EWCA Civ 1040 at paragraph 48:

"*The function of civil penalties is not compensatory. They are imposed in addition to the assessed liability for tax and the interest recoverable therein…the function of the penalties is one of punishment and deterrence vis the individual and general deterrence so far as taxpayers at large are concerned."*

462. The VAT sought to be evaded by Waterfire was the amount of input tax credit claimed by it in its VAT return for 04/06, namely £6,972,184. The statutory provisions are not said by the Appellant to be disproportionate per se and the Appellant has not identified any reasons why the penalty should be further reduced.

Discussion and Decision

463. I considered all of the submissions, documents and authorities to which I was referred. In order to expedite the release of this decision to assist the parties in their preparation for the forthcoming substantive hearing I will not refer to each and every authority in detail.

464. I also pause to observe that this decision does not pre-judge any of the issues to be determined at the substantive appeal. The Tribunal heard no evidence and I make no findings of fact. This decision is premised on the basis that the burden of proof rests with HMRC to prove the facts alleged.

465. My starting point is the basis of HMRC's decision to impose a penalty. Section 61 VATA 1994 provides for the liability of directors (of which there is no dispute that the Appellant was) where it appears to HMRC that, in the instant case, Waterfire is liable to a penalty under section 60 VATA 1994 and the conduct giving rise to Waterfire's penalty is attributable to the dishonesty of the Appellant.

466. Putting aside the issue of dishonesty for a moment, Section 60 provides for a penalty to be imposed against Waterfire where:

"*(a) for the purpose of evading VAT, a person does any act or omits to take any action, and*
(b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability)…"

467. Guidance is given as to the meaning of *"evading VAT"* in section 60 (2) which includes:

"…reference to obtaining any of the following sums-

(a) a refund under any regulations made by virtue of section 13(5);
(b) a VAT credit;
(c) a refund under section 35, 36 or 40 of this Act or section 22 of the 1983 Act; and
(d) a repayment under section 39,

in circumstances where the person concerned is not entitled to that sum."

468. HMRC's case, as pleaded in the Statement of Case, is that Waterfire's act of attempting to obtain a VAT credit took place in circumstances in which Waterfire was not entitled to such credit. I do not accept, as contended by Mr Mullen, that HMRC's case has been extended by the skeleton argument or that the skeleton argument is inconsistent with the case pleaded; the relevant paragraphs of the Statement of Case are set out in square brackets at (a) to (d) below. The circumstances are alleged to be that:

> (a) Waterfire knew that its transactions in 04/06 were connected to the fraudulent evasion of VAT [48, 49];
>
> (b) During the course of its trading history Waterfire acted as a contra trader by deliberately and artificially constructing its trading in such a way that enabled what would otherwise give rise to large claims for repayment from HMRC to be offset and made by other companies acting as broker traders [30, 31 – 47, 72];
>
> (c) By entering into those transactions and making VAT returns which included those transactions Waterfire had done an act by which it was not entitled to the right to deduct input tax [4, 74];
>
> (d) As Waterfire was not entitled to obtain a VAT credit, it had done an act for the purpose of evading VAT [74].

469. That Waterfire's entitlement to the right to deduct was lost in such circumstances was a principle recognised in law at the relevant time. The prevention of tax evasion has always been an objective under the Sixth Directive. Whilst I accept that case law was developing at the time when Waterfire carried out its transactions, jurisprudence was already in existence which had already established the principles relating to the refusal of the right to deduct. This was recognised by Moses LJ in *Mobilx:*

"This approach is the basis of the Court's approach not only in Kittel but in C-354/03 Optigen Limited v Customs and Excise Commissioners [2006] ECR I-483. The judgment in Optigen was handed down on 12 January 2006 by the third chamber of the court, four out of the five judges of which heard the case of Kittel and handed down their judgment six months later, on 6 July 2006. It is, therefore, not surprising that the court's reformulation of the questions in Kittel and its answers depended strongly on its approach in Optigen.

The scope of VAT is identified in Art. 2 of the Sixth Directive…The scope of VAT, the transactions to which it applies and the persons liable to the tax are all defined according to objective criteria of uniform application…

The principle of legal certainty requires that the application of Community legislation is foreseeable by those subject to it (see, e.g., the Advocate General's opinion in Optigen, § 42). The principle demands that when a taxable person enters into a transaction he should know that the transaction is within the scope of VAT and that his liability will be limited to the amount by which the output tax on his supply exceeds the input tax he has paid. In Optigen the court set out the criteria which identify the scope of VAT (see §§ 38-41). It emphasised the importance of the objective nature of those criteria (§§ 44-46). Once a transaction meets those criteria, it follows that the right to deduct for which Art. 17 provides must be recognised (§§ 52-53).

…Since the right arises immediately the taxable person pays tax (input tax) to his supplier, the principle of legal certainty demands that he knows when he enters into the transaction that it is within the scope of the tax and that his liability will be limited to the amount by which any output tax he may be liable to pay, on making a supply, exceeds the input tax he has paid. The objective criteria determine both the scope of the tax and the circumstances in which the right to deduct arises.

It was with those principles in mind that the ECJ in Optigen rejected the contention that the transactions of innocent parties could not be regarded as economic activities if they formed part of a series of transactions with a fraudulent objective (the argument which found favour before the Tribunal recited § 20). The Court repeatedly distinguished the transactions in which the innocent parties had entered from transactions "vitiated by VAT fraud" (see §§ 51, 52 and 55). It thus endorsed the view, expressed by the Advocate General, that regard must be had to the objective character of the concept of economic activity (§ 37 Advocate General's Opinion). It was the fact that the transactions of the unwitting traders in Optigen met the objective criteria which formed the basis of the ECJ's rejection of HMRC's attempt to deny repayment:-

"Therefore, the answer to the first question referred for a preliminary ruling in each case should be that transactions such as those at issue in the main proceedings, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge. The right to deduct input VAT of a taxable person who carries out such transactions cannot be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing. [emphasis added]" (§ 55)

It will be noted that the court in Optigen qualified its statement of principle by reference to the state of knowledge of the taxable person as to the fraudulent nature of another transaction."

470. In those circumstances I do not accept that the entire premise upon which HMRC imposed the penalty under section 61 VATA 1994 was based on *Kittel* or *Mobilx,* but rather well-established principles by which the right to deduct can be lost.

471. Although prima facie the right to deduct arises where the requirements of section 26 VATA 1994 are satisfied, it is clear that the principle had already been established prior to the decision in *Kittel* that the objective criteria which determine the scope of VAT and the right to deduct must have been met:

"In Kittel the Court adopted an identical approach to that which it had adopted in Optigen, emphasising the importance of the objective criteria which are met where a taxable person did not and could not know that the transaction was connected with fraud (§§ 39-52). Paragraph 52 (cited here at § 19) owes everything to Optigen's § 55."

472. The development in *Kittel* was simply consideration of the *"obverse of the question in Optigen"* (per Moses LJ in Mobilx at 34.) As such I reject the argument advanced on behalf of the Appellant that the penalty imposed by HMRC has no legal basis as the relevant transactions pre-dated *Kittel.*

473. I should note that the second question posed by *Kittel,* namely that relating to constructive knowledge, is not relevant to the issues to be determined in this case nor is it pleaded as part of HMRC's case. The case advanced is that the Appellant knew that its transactions were not only connected to fraud but that they formed part of that fraud. In this regard I adopt the words of Briggs J in *Megtian* at 21 – 25 in support of this contention:

"It is important to bear in mind, although the phrase "knew or ought to have known" slips easily off the tongue, that when applied for the purpose of identifying the state of mind of a person who has participated in a transaction which is in fact connected with a fraud, it encompasses two very different states of mind. A person who knows that a transaction in which he participates is connected with fraudulent tax evasion is a participant in that fraud. That person has a dishonest state of mind. By contrast, a person who merely ought to have known of the relevant connection is not dishonest, but has a state of mind broadly equivalent to negligence."

474. It therefore follows that if HMRC prove actual knowledge on the part of Waterfire, through the Appellant as a director, the element of dishonesty is satisfied.

475. Further, if the Appellant is proved to have the requisite knowledge and thereby his act of seeking to obtain input tax credit in such circumstances is an act for the purpose of evading VAT in that the entitlement to do so was lost, I am satisfied that the claim would be false. I do not agree with the submission on behalf of the Appellant that *"a false claim is one which has no basis whatsoever."*

476. In relation to this case, Mr Mullen argues that the Waterfire's claim does have a basis, namely input tax which was incurred, and therefore cannot be said to be false. In my view, to accept such a proposition would lead to the untenable conclusion that where a trader deliberately acts as a contra-trader for the purpose of dishonestly evading VAT, the claim would not be false. In my view this cannot be a proper interpretation or application of the legislation.

477. As to the issue of *"evasion"* I considered the narrow interpretation that Mr Mullen seeks to apply. Section 60 (2) specifically includes the obtaining of a VAT credit "*in circumstances where the person concerned is not entitled to that sum."* No further limitation is placed on the provision. I agree with the submissions on behalf of HMRC that the case of *Dealy* adds little by way of assistance on this issue; that case involved wholly different facts and the Court of Appeal was specifically concerned with section 39 VATA 1983. No consideration was given as to the meaning of *"evasion"* in the context of the circumstances in this case.

478. I do not accept Mr Mullen's submission that it *"can be seen by Kittel itself, the CJEU did not consider that persons denied input tax were engaged in evasion, but rather that such transactions were connected with evasion."* In rejecting this submission, I would again refer to Briggs J in *Megtian* (cited at paragraph 73 above) in which it is clear that where a person's actual knowledge is established (as is alleged in this case) that person has a dishonest state of mind and is deemed to be a participant in the fraudulent evasion of tax. In those circumstances I am satisfied that the provisions of section 60 can include situations whereby a taxpayer seeks to obtain a VAT credit where that taxpayer is not so entitled by reason of his knowledge of and participation in fraud.

479. The Appellant contends that the conforming interpretation applied by Moses LJ in *Mobilx* was limited to civil liabilities and therefore cannot apply to the imposition of a criminal penalty. It was accepted by HMRC that the imposition of a penalty under sections 60 and 61 VATA 1994 give rise to a criminal charge, however the relevance is referable to (see *Han and Yau*):

"…the threshold condition for application of the substantive provisions of Article 6 to the civil penalty procedures under s.60 of VATA and s.8 of FA 94. If applicable, there are implicit in the fair trial provisions of Article 6(1) rights which include a right to silence and a privilege against self-incrimination."

480. The appeal against the penalty to the First-tier Tax Tribunal is governed by civil procedures. Section 72(1) of the Act provides for the criminal liability of a person being knowingly concerned in, or in the taking of steps with a view to, the fraudulent evasion of VAT by himself or any other person. Although Mr Mullen appeared to suggest that the classification of a section 60 VATA 1994 penalty requires the appeal to be treated as a criminal matter in all respects, I do not accept this to be the case. The distinction was set out in *Han and Yau*:

"By way of contrast, if, under the prosecution policy criteria, the Customs and Excise consider that a criminal investigation with a view to prosecution is appropriate, and there is sufficient evidence to demonstrate reasonable grounds to suspect fraud prior to approaching the taxpayer, procedures appropriate to a criminal investigation will be followed. Customs investigators have powers to obtain search warrants and access orders and to arrest suspects, which powers are not available in a civil case. In addition, they conduct interviews in accordance with the requirements of the Police and Criminal Evidence Act 1984 ("PACE"), which normally take place in the presence of the taxpayer's solicitor and are conducted under caution without use of, or reference to, the inducement procedure.

It by no means follows from a conclusion that Article 6 applies that civil penalty proceedings are, for other domestic purposes, to be regarded as criminal and,

therefore, subject to those provision of PACE and/or the Codes produced thereunder, which relate to the investigation of crime and the conduct of criminal proceedings as defined by English law."

481. In those circumstances I do not agree that the issue of conforming interpretation arises simply because rights under Article 6 are invoked. Even if this is not correct, I am satisfied that the effect of classification of the penalty as a criminal charge is limited to engaging the Appellant's rights under Article 6 and 7 of the ECHR. In so far as Article 6 is concerned, Mr Mullen gave no detail as to the provision that the penalty is said to breach. Having considered the protection afforded by Article 6, I am satisfied that there are no breaches:

- The Appellant will receive a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law;

- The burden of proof lies with HMRC thereby preserving the presumption of innocence;

- The Appellant has been informed promptly and in detail of the nature and cause of the accusation against him in the form of decision letters from HMRC and a significant number of bundles of evidence;

- The penalty was imposed on 29 March 2010 since which date the Appellant has had adequate time and facilities for the preparation of his defence. The Appellant also has the benefit of representation, as I understand on a pro bono basis, by Counsel;

- The case has been allocated sufficient time for all witnesses required by the Appellant to be called to give evidence and examined.

482. That the fraudulent and dishonest evasion of tax could lead to the liability of a company (and its officials as the directing minds) for a penalty is long established by statute and case law. I do not accept that any further specific legislation is required or that the imposition of a penalty requires a conforming interpretation which extends beyond the jurisdiction of the Tribunal. In those circumstances I do not accept that the imposition of a penalty constitutes a breach of either Article 7 of the ECHR or Article 49 of the EU Charter.

483. Articles 49 also provides protection from disproportionate penalties. No specific arguments were advanced as to why the penalty is disproportionate save for references to the amount by which Waterfire could have profited from its transactions or the amount of VAT jeopardised which would require findings of fact. I accept the submissions on behalf of HMRC that the penalty was imposed in accordance with the relevant legislation and that *Han and Yau* provides support for the imposition of civil penalties:

"…the rationale for the VAT Civil Penalties Scheme was convincingly propounded in the Keith Report as a just balance between the legitimate interests of the Customs and Excise in improving the collection of a tax in relation to which widespread evasion was prevalent, and the interests of the taxpayer in avoiding the travails of a criminal prosecution and the stigma of conviction of a criminal offence of dishonesty in cases of deliberate evasion. It also represented a sensible rationalisation of the schemes for

collecting tax and penalising evasion as between the Customs and Excise on the one hand and the Inland Revenue on the other."

484. In principle I am satisfied, subject to any specific findings of fact made on the evidence, that the penalty is proportionate.

485. Article 50 of the EU Charter provides the right not to be tried or punished twice in criminal proceedings for the same criminal offence. I note and agree with Mr Benson QC's observation that the right to deduct was refused to the company and the penalty was imposed against the Appellant, two distinct legal entities. Furthermore I do not accept that the right to deduct can be properly regarded as a penalty such that any penalty imposed on Waterfire can be regarded as a second penalty; in this regard I respectfully agree with and adopt the comments of Moses LJ in *Mobilx* at paragraphs 64 and 65:

"On my interpretation of the principle in Kittel, there is no question of penalising the traders. If it is established that a trader should have known that by his purchase there was no reasonable explanation for the circumstances in which the transaction was undertaken other than that it was connected with fraud then such a trader was directly and knowingly involved in fraudulent evasion of VAT. The principle in Kittel, properly understood, is, as one would expect, compliant with the rights of traders to freedom from interference with their property enshrined in Art. I of the First Protocol of the European Convention of Human Rights. The principle in Kittel does no more than to remove from the scope of the right to deduct, a person who, by reason of his degree of knowledge, is properly regarded as one who has aided fraudulent evasion of VAT.

The Kittel principle is not concerned with penalty. It is true that there may well be no correlation between the amount of output tax of which the fraudulent trader has defrauded HMRC and the amount of input tax which another trader has been denied. But the principle is concerned with identifying the objective criteria which must be met before the right to deduct input tax arises. Those criteria are not met, as I have emphasised, where the trader is regarded as a participant in the fraud. No penalty is imposed; his transaction falls outwith the scope of VAT and, accordingly, he is denied the right to deduct input tax by reason of his participation."

486. I was invited to make references to the CJEU on the issues raised on behalf of the Appellant. Having found the matters acte clair I decline to do so.

487. For the reasons set out above I am not satisfied that the Respondent's case, or part of it, has no reasonable prospect of succeeding such that HMRC should be barred from taking further part in the proceedings. In such circumstances it must follow that the Appellant's application for summary determination is refused.

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

TRIBUNAL JUDGE
RELEASE DATE:

APPENDIX B: PTA DECISION

Appeal number: TC/2010/06495 & TC/2010/06596

FIRST-TIER TRIBUNAL
TAX CHAMBER

DECISION
ON AN APPLICATION FOR PERMISSION TO APPEAL
IN THE CASE OF

UMAAD BUTT **Appellant**

- and -

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

489. In an application dated 21 May 2014 the Appellant applied for permission to appeal against the First-tier Tribunal's decision dated 20 May 2014.

490. I considered in accordance with Rule 40 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 whether to review the decision in this appeal but decided not to undertake a review as I was not satisfied that there was an error of law in the decision.

491. The application is twofold:

(i) Permission to appeal against the decision not to postpone the substantive hearing currently listed on 16 to 27 June 2014.

(ii) Permission to appeal against the Tribunal's decision in respect of an application for summary judgment against HMRC in respect of a penalty issued on 29 March 2010 under section 61 Value Added Tax Act ("VATA") 1994.

Application for permission to appeal against the decision not to postpone the substantive hearing currently listed on 16 to 27 June 2014.

492. At the hearing of the application for summary judgment on 14 May 2014 I refused the Appellant's application to postpone the hearing due to commence on 16

June 2014. The hearing on 16 June 2014 was fixed by Judge Barlow at a directions hearing on 19 December 2013 at which counsel for both the Appellant and HMRC were present.

493. At the hearing on 14 May 2014 no satisfactory explanation was given as to why the date of 16 June 2014 cannot be met. I bore in mind the overriding objective and had regard to the complexity of the issues, anticipated costs and resources of the parties. The Appellant has had the benefit of representation by at least one counsel for a period of six months and the hearing date was fixed to accommodate counsel's availability. No further reasons are given as to why two barristers require additional time to deal with the evidence (see paragraph 1.6 of the application for permission to appeal).

494. The application makes reference (at paragraph 1.3) to the initial proposal to deal with the matter on the papers; this suggestion was made on the basis that both parties had sent in detailed skeleton arguments and was in no way referable to the June hearing.

495. As regards the Appellant's reliance on paragraph 63 of the decision in respect of the application for summary judgment, the full paragraph reads:

"I considered all of the submissions, documents and authorities to which I was referred. In order to expedite the release of this decision to assist the parties in their preparation for the forthcoming substantive hearing I will not refer to each and every authority in detail."

496. I will reiterate that all submissions, documents and authorities were considered. It is the duty of the Tribunal to provide sufficient reasons to support its decision and reasons for that decision. In *South Bucks D.C. v Porter (No. 2)* 2004 UKHL 33, [2004] 1WLR 1953, Lord Brown of Eaton-under-Heywood said the reasons must be:

> *"intelligible and they must be adequate. They must enable the reader to understand why the matter was decided as it was and what conclusions were reached on the 'principal important controversial issues', disclosing how any issue of law or fact was resolved...The reasons need refer only to the main issues in the dispute, not to every material consideration. Decision letters must be read in a straightforward manner recognising that they are addressed to parties well aware of the issues involved and the arguments advanced. A reasons challenge will only succeed if the party aggrieved can satisfy the court that he has genuinely been substantially prejudiced by the failure to provide an adequately reasoned decision."*

497. The decision set out the facts and arguments of both parties. Each material issue was addressed and reasons given for conclusions reached, citing where necessary the relevant authority.

498. The reference to costs made by the Appellant at paragraph 1.5 of the application is unclear. The application for summary judgment was decided on its merits. To allow the application solely on the basis of avoiding the potential costs of a substantive hearing would be wholly improper.

499. The application for permission to appeal in respect of the Tribunal's refusal to postpone the hearing listed on 16 June 2014 is refused.

Application for permission to appeal against the Tribunal's decision in respect of an application for summary judgment against HMRC in respect of a penalty issued on 29 March 2010 under section 61 Value Added Tax Act ("VATA") 1994.

500. The Appellant contends that the Tribunal misunderstood and failed to apply the principle that conforming interpretation cannot be applied to impose a penalty. Paragraphs 2.2 to 2.6 reiterate the oral submissions made at the hearing before me on 14 May 2014 which are set out within the decision. Paragraphs 79 to 82 of the decision set out the conclusions reached. I am satisfied that there was no error of law in this regard and permission to appeal is refused on this ground.

501. In respect of the Appellant's argument that the law was not sufficiently clear at the relevant time paragraphs 3.1 to 3.6 of the application for permission to appeal repeat the submissions made on 14 May 2014. The decisions reached on the various issues raised are set out at paragraphs 75 to 82 of the decision. I am satisfied that there was no error of law in this regard and permission to appeal is refused on this ground.

502. Paragraph 4 of the application for permission to appeal sets out the submissions advanced by the Appellant regarding Article 50 of the EU Charter which provides:

"No one shall be liable to be tried or punished again in criminal proceedings for an offence for which he or she has already been finally acquitted or convicted within the Union in accordance with the law."

503. The relevant part of the decision is at paragraph 85. The conclusion was reached after considering all of the authorities to which I was referred and I am satisfied that there was no error of law.

504. Paragraph 5 of the application refers to grounds which are said not to have been dealt with. Both arguments were fully considered in the context of the decision as a whole, in particular the decision in respect of the Appellant's arguments as to whether a claim could be false are set out at paragraphs 75 and 76 of the decision. The decision in respect of the Appellant's arguments on dishonesty is set out at paragraphs 73 and 74 of the decision.

505. The decision in respect of the arguments advanced as to proportionality are set out at paragraphs 83 and 84 of the decision. No specific findings were made where such would require evidence to be heard on the basis that the substantive hearing is the appropriate forum for findings of fact. I am satisfied that there was no error of law in this regard.

506. Permission to appeal the Tribunal's decision on summary judgment is refused.

507. Should the Appellant wish to renew its application to the Upper Tribunal any request to expedite proceedings should be notified accordingly.

508. If you are dissatisfied with the outcome of the application for permission to appeal the decision in this appeal, the Appellant has a right to apply to the Upper Tribunal for permission to appeal the decision in this appeal. Such an application must be made in writing to the Upper Tribunal at 45 Bedford Square London WC1B

3DN no later than one month after the date of this notice. Such an application must include the information as explained in the enclosed guidance booklet *Appealing to the Upper Tribunal (Tax and Chancery Chamber).*]

TRIBUNAL JUDGE
RELEASE DATE:

© CROWN COPYRIGHT 2014

APPENDIX C: PTA DECISION (UT)

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

Applicant: UMAAD BUTT	Tribunal Ref: PTA/490/2014
Respondents: The Commissioners for Her Majesty's Revenue and Customs	

APPLICATION FOR PERMISSION TO APPEAL

DECISION NOTICE

JUDGE ROGER BERNER

509. The Applicant, Mr Butt, applies to the Upper Tribunal (Tax and Chancery) for permission to appeal against two decisions of the First-tier Tribunal (Tax Chamber) ("FTT"). The first ("the postponement of hearing decision") was a decision on an application to vacate the substantive hearing of Mr Butt's appeal listed for two weeks from 16 June 2014 which was given by email on 23 April 2014, and repeated orally by the FTT Judge when the application was renewed at a hearing on 14 May 2014. The second, which followed the hearing on 14 May 2014, was a decision released on 20 May 2014 dismissing Mr Butt's application that HMRC be barred from taking further part in the proceedings and that the FTT summarily determine the appeal in favour of Mr Butt ("the summary judgment decision").

510. The First-tier Tribunal considered the applications by Mr Butt for permission to appeal, and refused each of them for the reasons given in a Decision Notice issued to the parties on 28 May 2014.

Summary judgment decision

511. In my judgment this application is misconceived. To succeed, it would be necessary for Mr Butt to demonstrate an arguable case that the FTT made an error of law in determining that HMRC's case in Mr Butt's appeal was not one that had no reasonable prospect of success. In other words, Mr Butt would have to show that the arguments raised by him, which the FTT considered, were unarguably bound to succeed.

512. That is a very high threshold, and it is one that Mr Butt cannot hope to reach on this application.

513. The misconception in Mr Butt's application is to argue that the FTT was wrong in its analysis of the legal arguments put before it. But it was not necessary, on an application of this nature, for the FTT to make any determination of those matters, any more than it would be for the Upper Tribunal to do so if this matter were to come before it on appeal. The FTT was careful to say, at [64], that it would not pre-judge the issues. An application to strike out, or obtain summary judgment, is not the same as a preliminary issue on the law which is then determined by the FTT.

514. The FTT decided that it was not satisfied that HMRC's case, or part of it, had no reasonable prospect of succeeding. It is perfectly plain from the FTT's decision that that was a conclusion the FTT was entitled to reach, and that there is no arguable error of law in the FTT's decision in that regard. The merits of the respective arguments should properly be considered by the FTT at the substantive hearing.

Postponement of hearing decision

515. Unusually, and contrary to the rules of the First-tier Tribunal (rule 35(4)), Mr Butt did not apply for full written finding and reasons in respect of the decision to refuse to postpone the June hearing before applying for permission to appeal that decision. Nonetheless, the application was entertained, and the FTT must be taken to have waived that breach.

516. In the application, counsel for Mr Butt set out the background to their involvement in his case on a *pro bono* basis which, in the case of Mr Mullen, commenced in December 2013. As regards the application to postpone, this was made on 15 April 2014, on the basis that the hearing be vacated until after the disposal of the summary judgment application. That, therefore, was the application that was before the FTT when it made its decision notified by email to the parties on 23 April 2014.

517. The scope for interference by the Upper Tribunal in case management decisions has recently been summarised succinctly by Sales J in *Revenue and Customs Commissioners v Ingenious Games LLP and others* [2014] UKUT 0062 (TCC), at [56]:

> "The proper approach for the Upper Tribunal on an appeal regarding a case management decision of the FTT is familiar and is common ground. The Upper Tribunal should not interfere with case management decisions of the FTT when it has applied the correct principles and has taken into account matters which should be taken into account and left out of account matters which are irrelevant, unless

> the Upper Tribunal is satisfied that the decision is so plainly wrong that it must be regarded as outside the generous ambit of discretion entrusted to the FTT: *Walbrook Trustees v Fattal* [2008] EWCA Civ 427, [33]; *Atlantic Electronics Ltd v HM Revenue and Customs Commissioners* [2013] EWCA Civ 651, [18]. The Upper Tribunal should exercise extreme caution before allowing appeals from the FTT on case management decisions: *Goldman Sachs International v HM Revenue and Customs Commissioners* [2009] UKUT 290 (TCC), [23]-[24]."

518. The grounds on which permission to appeal are sought assert that:

> (1) The FTT failed to give due regard to the overriding objective and to deal with the case fairly and justly. In this regard reference has been made to the complexity of the issues, and it is said that the FTT failed to give any or sufficient consideration to that, or to the anticipated costs and resources of the parties. It is submitted that the hearing date should not be met having regard to the preliminary issues raised by the summary judgment application and the possibility for finally determining the case on that basis.
>
> (2) The FTT failed to give due consideration to the fact that the substantive hearing is likely to be substantially shortened if the legal basis for the penalty has been finally determined. This includes an argument that the appeal against the summary judgment decision will occupy a substantially shorter time than the substantive hearing, and enable there to be a determination of the legal issues.
>
> (3) The FTT failed to give due consideration to the fact that counsel are acting *pro bono*, and that there are no solicitors or accountants dealing with the appeal. Reference is made to the number of lever arch files to be considered, and to the desirability that counsel should continue to offer their services.

519. To the extent that this application is focused on the prospect of the legal issues being determined on an appeal to the Upper Tribunal, those grounds are, for the reasons I explained earlier, misconceived. An appeal would examine only whether the FTT had made an error of law in refusing to exclude HMRC and summarily decide the appeal in Mr Butt's favour. It would not be a forum for the substantive determination of the legal issues. Contrary to the description in the application, the summary judgment application is not the same as an application to determine the legal issues as preliminary issues.

520. Given the limited scope for interference by the Upper Tribunal in a decision of this nature, I am not satisfied that there is an arguable case that the FTT made an error of law in this respect. It is not a question of whether another judge would have taken a different view. Although expressed in terms of the FTT failing to have due regard to the matters raised, the application in substance amounts to nothing more than a complaint that the FTT was wrong. That is not enough to found an appeal on a point of law.

521. I note that, at the date of the application, it was not known what volume of documents would be disclosed by HMRC in response to the direction of the FTT for disclosure by 30 May 2014. I am writing this decision on Friday, 30 May 2014, but it will not be released to the parties until the following Monday, 2 June 2014. It is not a

matter for the Upper Tribunal, but it will be open to Mr Butt to make a further application to the FTT for a postponement if he considers that such an application is appropriate, having regard to the disclosure that is made.

Decision

522. For the reasons I have given I refuse each of the applications for permission to appeal.

APPENDIX D: PTA DECISION (UT)

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

Applicant: Umaad Butt	Case number: PTA/490/2014
Respondents: The Commissioners for Her Majesty's Revenue and Customs	

APPLICATION FOR PERMISSION TO APPEAL
(Reconsideration at an oral hearing)

DECISION NOTICE

Introduction

1 In December 2013, the Applicant ("Mr Butt") applied to the First-tier Tribunal (Tax Chamber) ("FTT") for a direction under rule 8 of the Tribunal Procedure (First tier Tribunal) (Tax Chamber) Rules 2009 ("the FTT Rules") that the Respondents ("HMRC") be barred from taking further part in the proceedings and a summary decision that Mr Butt's appeal is allowed. The application was heard by the FTT (Judge Jennifer Blewitt) on 14 May 2014. Judge Blewitt released her decision, [2014] UKFTT 490 (TC), refusing the application on 20 May ("the Decision"). Mr Butt had also applied for the hearing of the appeal, listed for 16 - 27 June, to be postponed. That application was refused by email on 23 April and that decision confirmed orally at the hearing on 14 May.

2 Mr Butt applied to the FTT for permission to appeal against the Decision and the refusal to vacate the hearing. In a decision notice issued on 28 May 2014. Judge Blewitt refused to grant Mr Butt permission to appeal on either matter. Mr Butt then applied to the Upper Tribunal ("UT") under Rule 21 of the Tribunal Procedure (Upper Tribunal) Rules 2008 ("the UT Rules") for permission to appeal on the same grounds.

3 The UT (Judge Roger Berner) considered the application on the papers and, in a decision issued on 2 June 2014, refused permission to appeal on both matters. In

relation to the application for permission to appeal against the summary judgment decision, Judge Berner took the view that an application for summary judgment is not the same as a preliminary issue on the law which is then determined by the FTT. The FTT was not required to and did not determine the points of law that formed the basis of Mr Butt's application: it was only required to determine whether HMRC's case in Mr Butt's appeal was not oh&ihatTh1ad no reasonable prospect of success. Accordingly, Judge Berner refused Mr Butt's application for permission to appeal. In relation to the application to postpone the hearing, Judge Berner referred to the description of the proper approach to appeals against case management decisions by Sales J in Revenue and Customs Commissioners v Ingenious Games LLP and others [2014] UKUT 0062 (TCC), at [56]. Applying that approach, Judge concluded that there were no grounds to interfere with the FTT's decision not to postpone the hearing.

4 Mr Butt applied, under Rule 22(4) of the UT Rules, for Judge Berner's decision to refuse permission to appeal to be reconsidered at an oral hearing. A short hearing took place in London on 9 June 2014. Mr Butt was represented by Mr Rory Mullan and Ms Harriet Brown, counsel. HMRC were represented by Ms Karen Robinson, counsel.

Submissions and discussion

Approach to application for permission to appeal

5 Mr Mullan referred to Section 1 1 of the Tribunals, Courts and Enforcement Act 2007 which provides that any party has a right of appeal on any point of law, subject to permission being given. He contended that Mr Butt's application was based solely on points of law and the only question for the UT is what is the threshold for permission. He submitted that once the UT is satisfied that a point of law had been identified then it should give permission to appeal. I do not accept this view of the test for granting permission to appeal. Rule 39(5) of the FTT Rules provides that an application for permission to appeal must identify the alleged error or errors in the decision. Applying section 11 and rule 39, it is clear that there must be an error or errors of law in a decision before permission to appeal may be given. Before giving permission to appeal, the tribunal must be satisfied that it is arguable that there is an error of law in the FTT's decision. It is not enough for the applicant merely to identify a point of law. Further, I do not consider that permission should be granted unless the appeal has a real prospect of success (or unless there is some other compelling reason for the appellate court to hear the appeal). This is so even if there is some important point of principle or practice which is involved. If the answer to the important point is clear, in the sense of an appeal having no reasonable prospect of success, permission to appeal should not be given.

Decision on application for summary judgment

6 Mr Mullan submitted that, if it was necessary to identify them, there were errors of law in the Decision. He accepted, however, that if Judge Berner's description of the test for determining whether to give summary judgment was correct then he was also correct to refuse permission to appeal. Judge Berner said that the summary judgment application was not the same as an application to determine the legal issues as preliminary issues and the FTT had been careful to say, at [64], that it would not pre-judge the issues. Mr Mullan submitted that Judge Berner had applied the wrong test

in saying, at [3], that Mr Butt would have to show that his arguments were unarguably bound to succeed before he could be given permission to appeal. Mr Mullan contended that, where it was arguable that the FTT had made an error in its conclusions on Mr Butt's submissions on the law, Mr Butt must have a right of appeal. Mr Mullan submitted that Judge Berner was wrong to say, at [5], that an application to strike out, or obtain summary judgment, is not the same as a preliminary issue on the law. He pointed out that whether to determine a matter as a preliminary issue was in the discretion of the FTT whereas either party could make an application under rule 8 as of right.

7 I cannot accept Mr Mullan's submissions on this point. I consider that Judge Berner's description of the function of the FTT in dealing with an application for summary judgment was correct. In [3], he identified that the issue for the FTT was whether HMRC's case in Mr Butt's appeal was not one that had no reasonable prospect of success. He made the same point in giving his decision at [6], which I agree with and set out here because of its importance:

"The FTT decided that it was not satisfied that HMRC's case, or part of it, had no reasonable prospect of succeeding. It is perfectly plain from the FTT's decision that that was a conclusion the FTT was entitled to reach, and that there is no arguable error of law in the FTT's decision in that regard. The merits of the respective arguments should properly be considered by the FTT at the substantive hearing."

8 I consider that an application under rule 8(3) of the FTT Rules is not the same as a preliminary issue under rule 5(3)(e) of the FTT Rules. If the two applications were the same then there would be no point in having different rules for each. On an application under rule 8(3) of the FTT Rules, the task of the FTT is not to determine whether HMRC's case, or part of it, will be upheld after the substantive hearing by the tribunal deciding the appeal but whether that case has any reasonable prospect of success. That was the approach taken by the FTT (see 164J and 187]). Reasonable in the context of points of law means something more than fanciful or theoretical. Although I might not have used the phrase "unarguably bound to succeed", I note from one of the cases cited to me, that Lord Woolf MR said in Swain v Hillman [2001] 1 All ER 91 at 94 that (emphasis supplied):

"If a claimant has a case which is bound to fail, then it is in the claimant's interests to know as soon as possible that that is the position. Likewise, if a claimant is bound to succeed, a claimant should know that as soon as possible,"

9. At the risk of repetition, I agree with Judge Berner that the FTT was entitled to reach the conclusion, at [87], that it was not satisfied that HMRC's case, or part of it, had no reasonable prospect of succeeding and that the merits of the arguments should be considered by the FTT at the hearing. An appeal to the UT would not consider the merits of Mr Butt's submissions to the FTT on the law or the FTT's decision on those points. The UT could only consider whether the FTT had made any errors of law in reaching its conclusion. In effect that means that Mr Butt must establish that the FTT was not entitled to conclude that HMRC's case was not one that had no reasonable chance of succeeding. Accordingly and for the same reasons as Judge Berner, I refuse permission to appeal.

10 My conclusion does not mean that Mr Butt cannot appeal in relation to the

submissions on points of law that were not accepted by the FTT in relation to the application for summary judgment. I am not as certain as Judge Berner appeared to be, in [5], that the FTT was referring to the submissions which formed the basis of the application for summary judgment when it stated, at [64] of the Decision, that it had not pre-judged any of the issues to be determined at the appeal. I agree with Judge Berner, however that the merits of the respective arguments should properly be considered by the FTT at the substantive hearing. As discussed at the hearing before me, Judge Blewitt, who is due to hear the appeal, may decide that she does not need to hear full submissions on the points at the substantive hearing. Assuming that the FTT reaches the same conclusions in relation to the points in its full decision as it did in the Decision, Mr Butt will be able to appeal at that stage, subject to obtaining permission.

Application to postpone the hearing

11 Mr Mullan accepted that, if I were to decide that permission to appeal against the Decision should be refused, then Mr Butt's arguments for a postponement were weaker. Mr Mullan submitted that there were some grounds for appeal against the FTT's refusal to postpone the hearing even if there was to be no appeal. The difficulty faced by an applicant for permission to appeal a case management decision is that identified by Judge Berner at [9] and [12] of his decision. An appeal against such a decision is not a re-hearing of the application and the UT can only interfere with a decision of the FTT where there has been an error of law. The issue for the UT is not whether it would have made the same decision as the FTT. The only issue is whether the FTT made any error of law. Mr Mullan submitted that the FTT failed to take account of certain matters but, applying the approach described by Sales J in Ingenious Games, I do not consider that decision was so plainly wrong that it must be regarded as outside the generous ambit of the discretion entrusted to the FTT in matters of case management. Accordingly, I also refuse permission to appeal in relation to the FTT's decision not to postpone the hearing listed for 16 - 27 June 2014. I am reinforced in my decision on this point by the knowledge that any postponement of a case of this length would inevitably mean that it could not be re-listed for a year and that such a delay is not in the interests of either party.

Decision

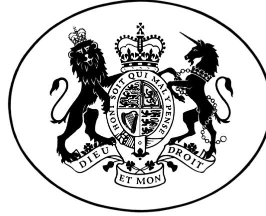
12 In conclusion and for the reasons given above, I refuse permission to appeal to the UT against the FTT's decisions in relation to the application for summary judgment and the application to postpone the hearing.

Signed: Date: 9 June 2014

GREG SINFIELD
JUDGE OF THE UPPER TRIBUNAL

Issued to the parties on: 10 June 2014

APPENDIX E: DISCLOSURE DIRECTIONS AND REFUSAL TO ADJOURN



Appeal number: TC/2010/06495 & TC/2010/06596

FIRST-TIER TRIBUNAL
TAX CHAMBER

UMAAD BUTT **Appellant**

- and -

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

TRIBUNAL: JUDGE J. BLEWITT

Sitting in public at Manchester on 14 May 2014

Having heard an application for disclosure by Ms Brown, Counsel for the Appellant and Ms Robinson, Counsel for the Respondents in response

IT IS DIRECTED that

523. By no later than 30 May 2014 HMRC must disclose to the Appellant:

(i) A printout from FAME for UK Express (Wholsesalers) Ltd confirming the incorporation date and date of dissolution;

(ii) H and O Trading Ltd deal logs for periods 11/05 and 02/06;

(iii) A printout from FAME that confirms Marshall Vincent Boston was a director of Marshall Boston and Sons Ltd;

(iv) The Mayfair Executive deal log for May and June 2006 showing 13 despatches to 2Trade BVBA and copy of the Tribunal decision confirming dismissal of Mayfair Executive's appeal.

(v) Visit reports or notes of meetings between HMRC and Waterfire and any such document showing contact between HMRC and the Appellant at his previous places of employment.

524. By no later than 30 May 2014 HMRC must confirm to the Appellant in writing the outcome of enquiries regarding paragraphs 53 and 891 of Mr Mody's witness statement.

525. Following a redacted copy of Mr Mody's witness statement being served and the Tribunal's indication that opinion evidence will be disregarded, the Appellant must confirm in writing by no later than 6 June 2014 whether it maintains its objection to paragraphs 23, 52, 127, 129, 131, 133, 135, 142, 156, 175, 176, 228, 239, 339, 451, 551, 891, 980, 982, 993, 999 and 1001.

526. The Appellant is granted (as notified by letter dated 1 May 2014) an extension for service of its list of issues and witness statement until 21 May 2014.

527. The remainder of the Appellant's application for disclosure is dismissed.

TRIBUNAL JUDGE
RELEASE DATE:

© CROWN COPYRIGHT 2014

Reasons

1. The Appellant served a detailed application for disclosure dated 13 May 2014 which was provided to me following the application by the Appellant for summary judgment in this case which was heard on 14 May 2014.

2. The application set out the background to the appeal, a summary of HMRC's main contentions, the basis of the Appellant's appeal, previous correspondence with HMRC and its position on disclosure, the disclosure sought, the relevant standard for disclosure and submissions on the effect of the engagement of the Appellant's rights under Article 6 of the ECHR.

3. The application notes that HMRC's case is heavily reliant on the statement of HMRC Officer Mr Mody who provided a statement addressing the trading activities of Waterfire Limited and its two directors, Mr Umaad Butt and Mr Tahir in support of HMRC's case to issue civil evasion penalties to Mr Butt and Mr Tahir pursuant to section 61 VATA 1994.

4. The two factual bases for the appeal are set out in the application as being that:

   (a) The "questionable transactions" (namely those by which HMRC allege that the Appellant, through Waterfire, acted dishonestly and with actual knowledge that the relevant transactions were fraudulent) were genuine commercial transactions; and

   (b) The Appellant had no actual knowledge of the fraud elsewhere in the chains of transactions.

5. The Appellant submitted that in order to support its case or consider its merits it must have access to the documentation and other evidence that forms the basis of HMRC's assertions that the facts set out in 4 (a) and (b) are untrue. In particular it is asserted that the Appellant is severely disadvantaged in a manner inconsistent with his Article 6 rights and the overriding objective of the Tribunal Procedure (First-tier) (Tax Chamber) Rules 2009 ("the Tribunal Rules") if he cannot understand the evidence, analysis and decision-making process behind the decision that the Appellant acted dishonestly and that Waterfire's trading was not commercial.

6. The headings of disclosure sought were:

   (a) All HMRC work materials generated in relation to Waterfire for the period from its incorporation until the date of this application;
   (b) All HMRC work materials generated in relation to the Previous Employers specific to Mr Butt for the respective periods of the Appellant's employment with each;
   (c) All HMRC work materials generated in relation to the Appellant's personal tax position as referred to in HMRC's Statement of Case and Mr Mody's witness statement;
   (d) Any document, correspondence or other evidence referred to in Mr Mody's statement which has not been exhibited;

(e) Any document, correspondence or other evidence in relation to:
   (i) Discussions (informal or otherwise), advice, emails, memoranda or other evidence of consultation with, advice from, or guidance issued by or within the MTIC fraud team as to the nature or style of proper commercial trading in mobile phones;
   (ii) Discussions (informal or otherwise), advice, emails, memoranda or other evidence of consultation with, advice from, or guidance issued by or within HMRC as to the nature or style of proper commercial trading in mobile phones;
   (iii) Expert advice received at the time of the decision to issue the penalty in relation to the nature or style of proper commercial trading in mobile phones;
   (iv) Discussions (informal or otherwise), advice, emails, memoranda or other evidence of consultation with, advice from, or guidance issued by or within the MTIC fraud team as to the indicia of MTIC fraud in mobile phone trading;
   (v) Discussions (informal or otherwise), advice, emails, memoranda or other evidence of consultation with, advice from, or guidance issued by or within HMRC as to the indicia of MTIC fraud in mobile phone trading; and
   (vi) Expert advice received at the time of the decision to issue the penalty in relation to the indicia of fraud in mobile phone trading.

(f) Any document, correspondence or other evidence generated before or after the production of Mr Mody's statement in relation to Mr Mody's opinions of Waterfire and the Appellant or those of any colleague of, or advisor to Mr Mody.

(g) Any internal memorandum relating to the decision to deny input tax, in particular any documentation on HMRC's policy on denying input tax claims;

(h) Any internal or external advice or guidance of HMRC as to what was normal commercial practice; and

(i) All internal correspondence, notes of internal meetings and conversations, memoranda or other HMRC documents concerning doubts over the validity of the original assessment.

7. Ms Brown helpfully set out the relevant standard of disclosure generally, as set out in Rule 27 of the Tribunal Rules:

(1) This rule applies to Standard and Complex cases.
(2) Subject to any direction to the contrary, within 42 days after the date the respondent sent the statement of case (or, where there is more than one respondent, the date of the final statement of case) each party must send or deliver to the Tribunal and to each other party a list of documents—
(a) of which the party providing the list has possession, the right to possession, or the right to take copies; and
(b) which the party providing the list intends to rely upon or produce in the proceedings.
(3) A party which has provided a list of documents under paragraph (2) must allow each other party to inspect or take copies of the documents on the list (except any documents which are privileged).

8. Ms Brown submitted that as the imposition of a penalty under section 61 VATA 1994 engages the Appellant's rights under Article 6 ECHR, the relevant standard for disclosure in this case is that set out in *Rowe and Davis* [2000] ECHR 91 (16 February 2000):

   "It is a fundamental aspect of the right to a fair trial that criminal proceedings, including the elements of such proceedings which relate to procedure, should be adversarial and that there should be equality of arms between the prosecution and defence. The right to an adversarial trial means, in a criminal case, that both prosecution and defence must be given the opportunity to have knowledge of and comment on the observations filed and the evidence adduced by the other party... In addition Article 6 § 1 requires, as indeed does English law... that the prosecution authorities disclose to the defence all material evidence in their possession for or against the accused..."

9. Ms Brown contended, citing *Edwards v UK* (judgment 16 December 1992) Series A no. 247-B in support, that *"material"* in the context of cases where Article 6 rights are engaged may have a wider meaning than "*relevant."*

10. I was also referred to *Fisher v HMRC* [2012] UKFTT 335 at paragraphs 14 - 16:

    "Reference was made to the apparent divergence on disclosure between standard disclosure under CPR which normally governs disclosure in the courts and the Rules governing disclosure in Tribunals. Rule 27(2) of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 provides that a party must disclose documents in its possession or control which he "intends to rely on or produce in the proceedings." CPR rules, at 31.6, in addition require a party to disclose documents which adversely affect his own case, adversely affect another party's case or support another party's case.

    *The Upper Tribunal (Administrative Appeals Chamber) in the case of Dorset Healthcare NHS Foundation Trust **v** MH [2009] UKUT 4 (ACC) ruled, in respect of virtually identical tribunal procedure rules on disclosure as apply in the Tax Chamber, that:*

    "[20] The starting point is that full disclosure of all relevant material should generally be given...."

    The next few paragraphs deal with when it might be right to withhold disclosure of relevant material such as where disclosure might be adverse to the health of the patient (irrelevant here) or relate to matters confidential to a third party. The general rule given by the Upper Tribunal was:

    "[25] Given the general rule in favour of full disclosure the burden will be on the responsible authority to demonstrate that it is appropriate to withhold disclosure of any particular documents."

    In conclusion, whatever the Tribunal Procedure Rules actually say, a party will be expected to disclose all relevant documents unless they can show withholding them is appropriate. I did not understand the parties to dispute this as a general principle: both parties were happy to agree to disclosure in accordance with standard disclosure under the CPR Rules. It was the application of the

disclosure obligation to the facts of this case where the parties diverged.

Although CPR 31.6 does not use the word "relevant", in requiring all material which positively or negatively affects any party's case to be disclosed, it seems to me that it does require all relevant material to be disclosed. At least in so far as there is a potential difference between these two concepts, nothing turns on it as far as this application is concerned. I consider that both parties should disclose (subject to the normal exceptions such as for privileged material) relevant documents within their possession or control."

11. Ms Brown contended that *"relevant"* evidence is that which positively or negatively impacts upon any party's case and which can only be determined by reference to the issues between the parties. Where Article 6 rights are engaged HMRC must disclose anything that is material so that the Appellant can decide what is relevant. It is not for the Tribunal to determine relevance; the only defence open to HMRC is that the requested evidence does not touch upon the case at all.

12. HMRC resisted the application save those contained in the direction above. It was observed by HMRC that the Appellant has yet to serve its list of issues or witness statement and that whilst HMRC will continue to review the issue of disclosure, at present all relevant items have been disclosed. By way of example HMRC rely on the Appellant's personal tax position; if the Appellant accepts the situation as outlined by HMRC then there will be no need to disclose documents, conversely if the Appellant disputes HMRC's assertions as to his tax position the relevant documents upon which HMRC rely to prove its case will be disclosed.

13. Furthermore it was submitted that any internal workings, conversations or opinions within HMRC do not form part of the pleaded case and are therefore irrelevant for the purposes of disclosure.

14. HMRC agreed to redact the statement of Mr Mody to address the Appellant's observations on Mr Mody's opinion evidence. HMRC has also confirmed that no policy documents exist in respect of denying input tax claims and therefore there is no policy to disclose.

Reasons for dismissal

15. In so far as is relevant, the Tribunal Rules provide as follows:

"Overriding objective and parties' obligation to co-operate with the Tribunal

2. *(1) The overriding objective of these Rules is to enable the Tribunal to deal with cases fairly and justly.*

(2) Dealing with a case fairly and justly includes—

(a) Dealing with the case in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties;
(b) Avoiding unnecessary formality and seeking flexibility in the proceedings;

(c) Ensuring, so far as practicable, that the parties are able to participate fully in the proceedings;
…

(3) The Tribunal must seek to give effect to the overriding objective when it—
(a) Exercises any power under these Rules; or
(b) Interprets any rule or practice direction.

Case management powers
***5.** (1) Subject to the provisions of the 2007 Act and any other enactment, the Tribunal may regulate its own procedure.*

(2) The Tribunal may give a direction in relation to the conduct or disposal of proceedings at any time, including a direction amending, suspending or setting aside an earlier direction.

(3) In particular, and without restricting the general powers in paragraphs (1) and (2), the Tribunal may by direction—

(d) Permit or require a party or another person to provide documents, information or submissions to the Tribunal or a party;
(e) Deal with an issue in the proceedings as a preliminary issue;
(f) Hold a hearing to consider any matter, including a case management hearing;
...

Evidence and submissions
***15.** (1) Without restriction on the general powers in rule 5(1) and (2) (case management powers), the Tribunal may give directions as to—*

(a) Issues on which it requires evidence or submissions;
(b) The nature of the evidence or submissions it requires;
…
(d) Any limit on the number of witnesses whose evidence a party may put forward, whether in relation to a particular issue or generally;
(e) The manner in which any evidence or submissions are to be provided...

(2) The Tribunal may—

(a) Admit evidence whether or not the evidence would be admissible in a civil trial in the United Kingdom;…”

16. In considering this application I had regard to the overriding objectives, the Tribunal Rules and the general principles relating to disclosure.

17. The Appellant appeared to suggest that the Tribunal has no power to determine issues of disclosure but rather that it is for the Appellant to decide what is relevant. I do not agree. It is clear that the Tribunal Rules provide this Tribunal with the power to decide such issues.

18. Whilst I accepted that the Appellant's Article 6 rights are engaged as a result of the imposition of a penalty under section 60 (1) VATA 1994 which gives rise to *"criminal charges"* within the meaning of Article 6 (1) of the ECHR, I do not accept that this classification modifies or extends HMRC's ongoing duty of disclosure to the extent submitted by the Appellant.

19. The ordinary test in respect of disclosure before this Tribunal is relevance, namely whether a document is likely to be relevant to the issues the Tribunal has to decide (subject to questions of privilege). In this case the Tribunal will have to determine whether the statutory provisions of section 61 VATA 1994 are satisfied.

20. It is a generally accepted principle that Rule 31.6 CPR provides guidance on the Tribunal's use of discretion although it does not form part of the Tribunal Rules:

    "Standard disclosure requires a party to disclose only–

    (a) the documents on which he relies; and
    (b) the documents which –
    (i) adversely affect his own case;
    (ii) adversely affect another party's case; or
    (iii) support another party's case;…"

21. I pause to observe at this point that the Appellant has yet to serve a witness statement, which does not assist me in determining this application. However from the submissions made by Counsel it would appear that the case for the Appellant is that the transactions undertaken by Waterfire were genuine, the Appellant had no knowledge of nor did he participate in a fraud and his actions were not dishonest.

22. On the basis of the limited information known as to the Appellant's case I can see no basis for concluding that HMRC has failed to disclose material or relevant evidence. Whether the term *"material"* or *"relevant"* is used, I do not accept the Appellant's submission that disclosable evidence includes any item that may potentially touch on the case; in my view to be disclosable the evidence must be relevant or material to the issues the Tribunal has to determine. It seems to me that the Appellant's Article 6 rights are not infringed in applying a test of relevance and materiality subject to proportionality.

23. I respectfully agreed with the comments of Judge Bishopp in *Calltell Telecom Ltd v HMRC* (2007) Decision 20266:

    "It is inevitable that, unless traders in the Appellants' position are conspirators in a fraud, they will not have access to the documents and information which the Commissioners are in a position to secure, and elementary natural justice demands that the Commissioners should be open and generous in determining the scope of the disclosure of documents which they offer, regardless of any direction by the tribunal.

    …The provisions of Part 31.7 of the Civil Procedure Rules are not, strictly, binding on this tribunal but they provide a useful guide: each party to litigation is

subject to a duty of search tested by the yardsticks of reasonableness and proportionality, taking into account:
"(a) the number of documents involved; (b) the nature and complexity of the proceedings; (c) the ease and expense of retrieval of any particular document; and (d) the significance of any document which is likely to be located during the search."

…It is necessary to strike a reasonable balance between an appellant's need to have access to documents within the Commissioners' power but not their own, while the burden to be imposed on the Commissioners must not be excessive, and the disclosure required must be of relevant material—the tribunal must not permit disclosure to be used as a tactical device.

…It is clear that it is not the Commissioners' function to pursue investigations indefinitely and regardless of expense merely because they might discover something of help to an appellant…Additionally, even though some of the…sought were, clearly, within the Commissioners' possession because they had themselves created them, there must be a reasonable limit to the extent to which the Commissioners are required to trawl even through their own records in case something of relevance might be found…

Unless a specific direction in some other form is made, it is our view that the appropriate course for the Commissioners to adopt in cases of this kind is to serve a list of the documents on which they intend to rely (with supplementary lists if further documents become available—the duty of disclosure, in this tribunal as elsewhere, is a continuing one) and at the same time to serve a list, by category rather than individually if the labour of so listing them would be disproportionate, of those other documents in their possession which relate to the transactions in question but on which they did not intend to rely (irrespective of their perceived relevance to the issues between the parties), and to allow an appellant or his advisers access to those documents…"

24. In my view the Appellant's request for disclosure is too unfocussed and lacks relevance to the issues in the case. To direct disclosure in the terms sought would be to burden HMRC with an onerous exercise; one which cannot be considered proportionate or reasonable.

25. The Appellant has failed to justify the relevance of any of the documents sought or why such documents are material by reference to the issues for the Tribunal to determine in the appeal. By way of example it was suggested that HMRC's internal papers or working notes of an HMRC officer (if indeed such documents exist) might show that HMRC's view was reached on an erroneous basis or that officers within HMRC held a different personal view to that publicly stated by HMRC. In my view these matters are not relevant or material to the issues (such that they are known) in the case. The appeal does not involve a review of an HMRC officer's decision but rather whether the statutory criteria of section 61 VATA 1994 are satisfied on the evidence before the Tribunal. Any views of HMRC officers, whether in accordance with HMRC's public statements or not, are also irrelevant and immaterial.

26. I am also requested to direct HMRC to provide a disclosure statement as provided for by CPR 31.10 (6):

"A disclosure statement is a statement made by the party disclosing the documents –
(a) setting out the extent of the search that has been made to locate documents which he is required to disclose;
(b) certifying that he understands the duty to disclose documents; and
(c) certifying that to the best of his knowledge he has carried out that duty."

27. I do not consider the circumstances of this case are such as to require such an exceptional step and I do not make such a direction.

Appeal number: TC/2010/06495 & TC/2010/06596

FIRST-TIER TRIBUNAL
TAX CHAMBER

UMAAD BUTT **Appellant**

- and -

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

TRIBUNAL: JUDGE J. BLEWITT

Having considered a written application for disclosure made on behalf of the Appellant dated 2 June 2014 and HMRC's response by email dated 4 June 2014, the application is refused.

Background

28. The Appellant served an application for disclosure by email dated 2 June 2014. The nature of the application was two-fold: the Appellant sought disclosure of HMRC policy documents and copies of legal advice provided to HMRC officers who are due to give evidence in the forthcoming appeal.

29. The Appellant contended that *"it would be unusual and uncharacteristically negligent if HMRC did not have a policy concerning claims for input tax in markets where MTIC fraud was rife."* It was submitted that any such policy or policies are relevant to the substantive appeal for the following reasons:

(a) HMRC policy in relation to markets affected by MTIC fraud is relevant as it is suggested by HMRC that actions of so called buffer traders and contra traders did not represent normal commercial activities. Consideration must be

given to the distortions caused to the relevant markets by HMRC policies. It is the Appellant's case that trading patterns of the Waterfire and other participants in the market represented a rational commercial response to HMRC policies and in order to advance this case it is necessary to fully understand what the HMRC policies were at the relevant time.

(b) The Appellant relied heavily on representations from HMRC as to what he could and could not do, and as to the risks of taking certain steps. It is the Appellant's case that at no time was it represented to him that mere knowledge of MTIC fraud in a supply chain would be regarded as making him a participant in fraud. The HMRC policy in dealing with traders generally is relevant to the issue of what the Appellant might reasonably have regarded as honest or dishonest.

30. An order for disclosure of the following documents concerning HMRC policy or practice in the period from 2000 to 2007 was sought:

(i) Any documents relating to practice and policy of HMRC which can be regarded as relevant to the Appellant's case as set out above

(ii) Any documents relating to the practice and policy of refusing input tax by reference to a lack of economic activity (which lead to the appeals in *Optigen* and *Bond House* against a denial of input tax).

(iii) Any documents relating to the practice and policy of dealing with cases where input tax had previously been denied following the decision of the CJEU in *Optigen*.

(iv) Any documents relating to the practice and policy of making claims for input tax subject to an extended verification process.

(v) Any documents considering the effect of the extended verification policy on the markets where it applied.

(vi) Any documents relating to the practice and policy of selecting input tax claims for an extended verification process.

(vii) Any documents relating to any other practice or policy whereby input tax claims might be delayed, refused or in any way treated differently than claims which would be made in markets where MTIC fraud was not considered a risk.

(viii) Any documents relating to the practice and policy of communicating with participants in markets where MTIC frauds including guidance issued to traders and copies of pro forma letters which were made available to HMRC staff to send to traders.

31. The Appellant also requested an order that HMRC provide copies of all legal advice which has been referred to in witness statements on the basis that: *"it seems likely that some of the witnesses are referencing legal advice previously given to HMRC. This particularly appears to be the case in relation to the*

witness statement of Rod Stone. As it is established that a party to proceedings cannot cherry pick those parts of privileged advice in relation to which it chooses to waive privilege, the Appellants really should be given access to the entirety of the advice being referenced."

32. HMRC resisted the application on the basis that the reasons provided are insufficient and consequently no such materials relating to policy fall to be disclosed.

33. HMRC noted that within the List of Issues served by the Appellant, three matters are accepted: that there was in this case a missing trader fraud; that the Respondents have correctly identified those transactions which can be traced to fraudulent defaulting traders within the missing trader fraud; and that the Respondents have correctly identified those participants in the transaction chains which can be traced to fraudulent defaulting traders within the missing trader fraud.

34. HMRC submitted that the facts and matters relevant to the issues to be determined by the Tribunal are those which were known to the company at the relevant time, those which were available to the company at that time and those which could have been known to the company had proper enquiry been made by it. What is important is what information was *in fact* communicated to the Waterfire by HMRC, and particularly to the Appellant in his position as Director of Waterfire.

35. As regards the application for copies of legal advice, HMRC submitted that in the absence of any particulars or references to relevant witness statements (and paragraph numbers therein) within the application, it is impossible for the Respondents to provide a detailed and considered response.

<u>Reasons</u>

36. In considering this application I had regard to and applied the overriding objective, the Tribunal Procedure (First-tier) (Tax Chamber) Rules 2009 and the general principles relating to disclosure.

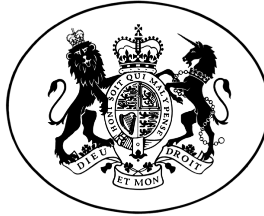
37. On the basis of the limited information known as to the Appellant's case (no witness statement having yet been served) I agree with the submissions of HMRC. There is no basis for the suggestion that any policies - if indeed any such policies existed at the relevant time - impacted on the Appellant's state of mind or manner of trading (or that of any other trader).

38. The issue of the Appellant's knowledge is one of the principle issues to be determined in this case in the context of whether the statutory provisions of sections 60 and 61 VATA 1994 are satisfied. In those circumstances, taken together with the absence of any evidence from the Appellant to suggest that he was made aware of or influenced by any policy, the relevant material is that which was communicated to Waterfire, and particularly the Appellant as director. In this regard HMRC has, as I understand it, fulfilled its duty of disclosure by serving copies of correspondence from HMRC to Waterfire Ltd, and notes /

records of meetings and communications with Waterfire Ltd (and specifically the Appellant).

39. In respect of the Appellant's request for copies of any legal advice given to HMRC, I noted that the application goes only so far as to state: *"it seems likely that some of the witnesses are referencing legal advice previously given to HMRC"* (emphasis added) albeit with reference to the statement of Mr. Stone. No explanation or detail has been provided by the Appellant as to the basis for such an assertion, nor have any specific references been provided in support of it. In those circumstances I agree with HMRC; to direct disclosure in the terms sought, given the volume of evidence in this case, would be to burden HMRC with an excessively onerous task; one which cannot be considered proportionate or reasonable.

40. For the reasons set out above the Appellant's application is refused.



Appeal number: TC/2010/06495 & TC/2010/06596

FIRST-TIER TRIBUNAL
TAX CHAMBER

UMAAD BUTT **Appellant**

- and -

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

TRIBUNAL: JUDGE J. BLEWITT

528. By email dated 6 June 2014 the Appellant requested that I reconsider my direction in respect of disclosure dated 6 June 2014. I have treated the request as an application under Rule 6 (5) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Tribunal Rules") which provides as follows:

"If a party or other person sent notice of the direction under paragraph (4) wishes to challenge a direction which the Tribunal has given, they may do so by applying for another direction which amends, suspends or sets aside the first direction."

529. The basis for the application is that, in considering the Appellant's application for disclosure, I did not have regard to the Appellant's witness statement which was served on 21 May 2014 but which had regrettably not been placed on the Tribunal file. In those circumstances I have reconsidered my decision taking account of the Appellant's witness statement.

530. The background and grounds for disclosure was set out in full in the direction dated 6 June 2014 and I do not intend to repeat the contents. In summary the Appellant sought disclosure of HMRC policy documents and copies of legal advice provided to HMRC officers who are due to give evidence in the forthcoming appeal.

531. In my view the Appellant's witness statement does not change the conclusions reached in my refusal of the Appellant's application for disclosure which I adopt, but do not repeat, herein.

532. In respect of the further grounds submitted by the Appellant in the email dated 6 June 2014, the manner in which the Appellant conducted his trading, his state of mind and the way in which he interpreted information provided by HMRC are matters upon which the Appellant can give evidence. I agree with the observations of HMRC set out in an email dated 9 June 2014 (served in response to the Appellant's application for reconsideration of the direction dated 6 June 2014) that the Appellant can only give evidence about the information he had. Any HMRC policy is irrelevant to the issue of the Appellant's state of mind and cannot be said to have influenced him.

533. The Appellant notes that *"HMRC rely heavily on circumstantial evidence…and if they wish to rely on circumstantial evidence the solid evidence on which they base that, and the policy underlying why they believe the circumstantial evidence to support their case must also be relevant."* HMRC bear the burden in this case and the evidence, circumstantial or otherwise, is a matter which will be assessed by the Tribunal. HMRC's beliefs in respect of that evidence are irrelevant as is any "*policy underlying why they believe the circumstantial evidence to support their case."*

534. It is submitted that the Appellant makes clear in his statement that his state of mind was *"heavily influenced by not only what he was told by HMRC but the way in which they behaved in relation to MTIC fraud and enforcement…for example through information that was widely publicly available and attitudes in industry generally."* Again, in my view this is a matter upon which the Appellant can give evidence as to what information and attitudes he was aware of and how this impacted on his trading. Any policy held by HMRC is irrelevant to this issue.

535. Having considered the extract from Lester & Pannick referred to by the Appellant, I do not accept that the Appellant's Article 6 rights are breached by the refusal of disclosure of any policy. Furthermore I do not accept that there is any basis for the suggestion that any such policy could impact on the credibility of the HMRC officers giving evidence and I note that there is no suggestion in the Appellant's witness statement that information provided by any specific officer was contrary to the public information available to the Appellant (such as HMRC's leaflets on "how to spot a missing trader").

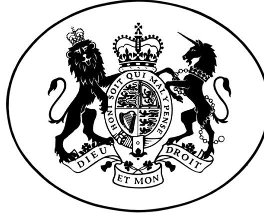
536. The Appellant has failed to justify the relevance or materiality of the items sought to the issues for the Tribunal to determine in the appeal. The application is therefore refused.

537. I also refuse the Appellant's application to adjourn. The 10 day hearing is sufficient to conclude the evidence in the case and a date for oral closing submissions will be fixed on the earliest possible date convenient to the parties, as commonly occurs in such cases. This will afford the parties the opportunity to serve written closing submissions to assist the Tribunal in advance of the hearing. No reasons have been provided as to why the recent disclosure (which amounts to a single lever arch file) necessitates a postponement and the delay caused in granting such a postponement (which I understand would be in the region of 12 months) would not, in my view, be in the interests of either party.

JUDGE BLEWITT

TRIBUNAL JUDGE
RELEASE DATE: 13 OCTOBER 2015

APPENDIX F: RECUSAL



Appeal number: TC/2010/06495

PROCEDURE – application for judge to recuse herself following summary judgment decision and decisions in respect of disclosure – application refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

UMAAD BUTT **Appellant**

- and -

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

TRIBUNAL: JUDGE J. BLEWITT

Sitting in public at Manchester on 16 June 2014

Mr Rory Mullen leading Ms Harriet Brown, Counsel for the Appellant

Mr Jeremy Benson QC leading Ms Karen Robinson, Counsel instructed by HM Revenue and Customs, for the Respondents

© CROWN COPYRIGHT 2014

DECISION

Application

538. In written opening submissions sent to the Tribunal on 15 June 2014 the Appellant made an application that I should recuse myself from hearing the substantive appeal on the basis that *"a fair minded and informed observer would conclude that there was a real possibility that she has pre-judged a major part of the issues in the appeal."* At the commencement of the hearing on 16 June 2014 I proceeded to hear oral submissions from both parties.

Introduction and Background

539. This appeal involves a penalty imposed by HMRC on the Appellant on 29 March 2010 pursuant to section 61 VATA 1994. The penalty was imposed in respect of the Appellant's conduct as a director of Waterfire Ltd ("Waterfire") which HMRC allege entered into various transactions and rendered VAT returns for the purpose of evading VAT. HMRC submit that the company made claims to input tax credit when it knew that the underlying transactions were connected with fraud, thereby seeking to evade £6,972,184 in VAT period 04/06. HMRC contend that the conduct giving rise to Waterfire's liability to a penalty was wholly, or in part attributable to the conduct of Mr Butt as a director and 50% shareholder of the company.

540. An application was made by the Appellant for summary judgment against HMRC in respect of the penalty issued on 29 March 2010. The case was argued orally before me on 14 May 2014 and my decision released to the parties on 20 May 2014. I will not repeat the contents of that decision save to say that I refused the Appellant's application on the basis that I was not satisfied that the Respondent's case, or part of it, has no reasonable prospect of succeeding such that HMRC should be barred from taking further part in the proceedings.

541. The Appellant sought leave to appeal that decision on 21 May 2014. I refused permission to appeal on 28 May 2014 on the basis that I was satisfied that there was no error of law contained within the decision.

542. The Appellant renewed its application for permission to appeal to the Upper Tier. Permission was refused on the papers by Judge Berner on 2 June 2014 and following an oral hearing by Judge Sinfield on 9 June 2014.

543. In the lead up to this hearing I have also dealt with a number of applications by the Appellant for disclosure in decisions dated 23 May 2014, 6 June 2014 and 11 June 2014.

A Summary of the Appellant's submissions

544. In making this application the Appellant relies on:

(a) The summary judgment decision dated 20 May 2014;

(b) Refusal of leave to appeal dated 28 May 2014; and

(c) The decisions in respect of disclosure dated 23 May 2014, 6 June 2014 and 11 June 2014.

545. I was referred to the recent authority of *Dar Al Arkan Real Estate Development Company and another v Al Refai and others* [2014] All ER (D) 91 ("*Dar*") in which Smith J recused himself from hearing a committal application in light of findings made by him in an earlier judgment from which the fair minded observer would conclude that there was a real possibility that he may have pre-judged a major part of the issues [32 – 36]

> *"In their application notice the claimants say that I should recuse myself from hearing the committal application "because in light of the findings made by [me] in [my] judgment dated 12 December 2012, a fair minded and informed observer would conclude that there was a real possibility that [I] might have pre-judged a major part of the issues in the Contempt Application"...*
>
> *The governing principles were not controversial:*
>
> *i) The test of apparent bias laid down in Porter v Magill reflects Strasbourg jurisprudence, and there is no relevant distinction between the common law and the requirements of article 6 of the European Convention on Human Rights.*
>
> *ii) Apparent bias is not demonstrated by "the mere fact that a judge, earlier in the same case or a previous case, has commented adversely on a party or a witness, or found the evidence of a party or witness to be unreliable": per Bingham LCJ, Lord Woolf MR and Sir Richard Scott V C in Locabail (UK) Ltd v Bayfield Properties Ltd, [2000] QB 451 at para 25.*
>
> *iii) However, there are circumstances in which, as it was put by the High Court of Australia in Livesey v New South Wales Bar Association (1983) 151 CLR 288, 300, "... a fair-minded observer might entertain a reasonable apprehension of bias by reason of pre-judgment if a judge sits to hear a case at first instance after he has, in a previous case, expressed clear views either about a question of fact which constitutes a live and significant issue in the subsequent case or about the credit of a witness whose evidence is of significance on such a question of fact"*
>
> *iv) Cases in which there is any real ground for doubt should be resolved in favour of recusal. A judge should decline to hear a case only for proper and sufficient reason to do so: recusal is not an excuse for avoiding embarrassment. I was referred to a number of authorities about when a judge should stand aside, but in the end the enquiry is fact specific: see*

the Locabail case at para 25.

Mr Béar put the application wholly on the basis that in my December 2012 judgment:

5 *i) I rejected as dishonest evidence of the claimants' witnesses, and*

ii) As a result I reached conclusions adverse to the claimants and Sheikh Abdullatif on specific issues that are important to the committal application.

These findings and this conclusion really go to the heart of the contempt application. If they are correct, the claimants are guilty of a serious breach of
10 *at least the preservation undertaking. Of course, as Mr Orr emphasised, on the committal application Kroll will have to prove their allegations to the criminal standard, and in my December 2012 judgment I was concerned with proof to the civil standard. But, as Keene LJ said in Sengupta v Holmes, [2002] EWCA Civ 1104 at para 44, what matters is whether "a judge in*
15 *reality is having to decide the same question on which he has previously reached a determination". The allegations were of dishonesty and other impropriety, and therefore the evidence had to be the more cogent to establish them to the civil standard (see para 45 of my judgment) and I do not consider that "in reality" the standard of proof is a telling distinction. It is, if anything,*
20 *more "tenuous" than the difference that in Hauschildt* **v** *Denmark, (1989) 12 EHRR 266 the European Court of Human Rights thought insufficient to prevent an appearance that the court was not impartial (esp at paras 52 and 53).*

546. The Appellant referred to the Upper Tier decision of Judge Sinfield dated 9 June
25 2014 in which it was stated at [7]:

"…I consider that Judge Berner's description of the function of the FTT in dealing with an application for summary judgment was correct…he identified that the issue for the FTT was whether HMRC's case in Mr Butt's appeal was not one that had no reasonable prospect of success. He made the same point in
30 *giving his decision at [6], which I agree with and set out here because of its importance:*

> *"The FTT decided that it was no satisfied that HMRC's case, or part of it, had no reasonable prospect of succeeding. It is perfectly plain from the FTT's decision that that was a conclusion that the*
> 35 *FTT was entitled to reach, and that there is no arguable error of law in the FTT's decision in that regard. The merits of the respective arguments should be properly considered by the FTT at the substantive hearing.""*

547. The Appellant contends that the same issues as those which arose in *Dar* arise
40 in this case; namely that *"having decided the issues in the summary judgment*

application by reference to the test of no reasonable prospect of success (and leave to appeal having been refused by reference to that test imposing a high burden)" I will now be required to determine the legal arguments by reference to the normal civil standard. The Appellant questions whether, in such circumstances, a reasonable observer might conclude that I would not be able to put myself back into a state of mind with *"no preconceptions about the merits of the case"* particularly given the fact that full oral arguments were heard. The issue, Mr Mullan explains, is not that the Tribunal would not be, as a matter of fact, fair and unbiased but rather that justice must not only be done but be seen to be done. Should the appeal proceed to be heard by me (sitting with a member) there is concern that the Appellant's Article 6 rights will be infringed.

548. Mr Mullan accepts that a point of distinction arises as between the case of *Dar* and Mr Butt's appeal in that in the appeal before me there has been no assessment of factual matters and the decision following the Appellant's application for summary judgment was confined to legal arguments in respect of which a different test was applied to that which applies to the substantive appeal. Mr Mullan concedes that in such circumstances a fair minded observer may have less concern however the question as to whether there is a real risk of the appearance of bias must still be asked.

549. I was referred to the case of *Dr Sengupta & Mr Thomas* [2002] EWCA Civ 1104 in which it was stated [32 – 37]:

> *…If a judge has presided at a first instance trial and roundly concluded on the facts – after hearing disputed, perhaps hotly disputed, evidence – that one of the parties lacks all merit, everyone would accept that it would be unthinkable that he should sit on that party's appeal. He has committed himself to a view of the facts which he himself had the responsibility to decide. This is the kind of circumstance referred to in the High Court of Australia in Livesey. It is also, I think, at least comparable with the state of affairs that arose in Hauschildt.*
>
> *In some such cases the judge's inability to open his mind on the appeal would be not just apparent, but real: if after a careful and professional review of all the evidence, given by witnesses whom, so to speak, he has looked in the face, he has arrived at the conviction that the party in question is a crook or a rogue, guilty as charged (whether the case is criminal or civil), he might not conscientiously be able to put himself back into a state of mind where he has no preconceptions about the merits of the case.*
>
> *There may also be cases, though one hopes there will not be, in which a judge called on to make a preliminary decision expresses himself in such vituperative language that any reasonable person will regard him as disqualified from taking a fair view of the case if he is called on to revisit it.*
>
> *…But the ordinary case is far from those instances. It is of the kind that has happened here: the judge in question has not himself had to resolve the case's factual merits, and has not expressed himself incontinently. All he has done is to conclude on the material before him that the result arrived at in the court below*

was correct. And he has done so in the knowledge that, at the option of the applicant, his view may be reconsidered at an oral hearing. In such a case is there a reasonable basis for supposing that he may not bring an open mind to bear on the substantive appeal if, after permission granted by another judge, he is a member of the court constituted to deal with it?

I consider, in line with a submission made by Mr Pollock, that an affirmative answer to this question would travel beyond whatever is the perception of our courts and judges that may be entertained by the fair-minded and informed observer, whoever he may be. It is not only lawyers and judges who in various states of affairs may be invited – they may invite themselves – to change their minds. Absent special circumstances a readiness to change one's mind upon some issue, whether upon new information or simply on further reflection, and to change it from a previously declared position, is a capacity possessed by anyone prepared and able to engage with the issue on a reasonable and intelligent basis. It is surely a commonplace of all the professions, indeed of the experience of all thinking men and women."

550. Mr Mullan submits, relying on *Dr Sengupta*, that my refusal of leave to appeal against the decision dated 20 May 2014 indicated that a view had been formed to a fuller extent than would otherwise be the case, as I understand it had my involvement been limited to the decision on summary judgment only.

551. Mr Mullan submits that although the relevant decisions in respect of disclosure would not, in isolation, be sufficient to warrant recusal, when viewed in the context of the summary judgment decision and refusal of permission to appeal they add weight to the application. By way of example the Appellant referred to the decision dated 6 June 2014 in which it stated: *"there is no basis for the suggestion that any policies…impacted upon the Appellant's state of mind…"* Mr Mullan contends that the decisions on disclosure concern a live issue in the substantive appeal and the comments made by me in the decisions are indicative of having pre-judged a central issue in the Appellant's case; namely that Waterfire's actions in trading were explicable by reference to a policy of HMRC which created commercial disincentives to trade in a manner which led to VAT repayment claims.

552. One of the issues in the case is whether or not the conduct of the Appellant and/or Waterfire was dishonest which requires the application of the *Ghosh* test. Mr Mullan contends that by suggesting that the only relevant issue was the Appellant's state of mind, the fair minded observer is likely to conclude that I have already formed a view in respect of objective dishonesty.

HMRC's submissions

553. On behalf of HMRC Mr Benson QC highlighted that in my decision dated 20 May 2014 I stated at [64] and [87]:

"I also pause to observe that this decision does not pre-judge any of the issues to be determined at the substantive appeal. The Tribunal heard no evidence and

I make no findings of fact. This decision is premised on the basis that the burden of proof rests with HMRC to prove the facts alleged...

For the reasons set out above I am not satisfied that the Respondent's case, or part of it, has no reasonable prospect of succeeding such that HMRC should be barred from taking further part in the proceedings. In such circumstances it must follow that the Appellant's application for summary determination is refused."

554. I was also referred to the decision of Judge Berner in which he stated at [5] and [6]:

"The misconception in Mr Butt's application is to argue that the FTT was wrong in its analysis of the legal arguments put before it. But it was not necessary, on an application of this nature, for the FTT to make any determination of those matters, any more than it would be for the Upper Tribunal to do so if this matter were to come before it on appeal. The FTT was careful to say, at [64], that it would not pre-judge the issues. An application to strike out, or obtain summary judgment, is not the same as a preliminary issue on the law which is then determined by the FTT.

The FTT decided that it was not satisfied that HMRC's case, or part of it, had no reasonable prospect of succeeding. It is perfectly plain from the FTT's decision that that was a conclusion the FTT was entitled to reach, and that there is no arguable error of law in the FTT's decision in that regard. The merits of the respective arguments should properly be considered by the FTT at the substantive hearing."

555. Mr Benson QC submits that the circumstances in the case of *Dar* upon which the Appellant relies in support of this application were wholly different to that in Mr Butt's appeal. In particular Mr Benson QC notes that Smith J in *Dar* accepted that:

"I conclude that I should recuse myself. I have not simply expressed views about issues that will arise on the committal application and witnesses who might well give evidence when it is heard. My judgment of December 2012 goes beyond that: my views about the credibility of the witnesses were detailed and specific, and I have reached conclusions adverse to the claimants not only on some questions that might arise on the hearing of the committal application, but on issues that are likely to be crucial and possibly on all the real issues that will arise. Moreover, although I do not know and Mr Béar understandably declined to say what evidence might be adduced by the claimants and Sheikh Abdullatif in response to the committal application, it seems likely that it will depend on essentially the same evidence as I heard on the discharge application, and it might well be that the submissions will also be largely similar. (I considered deferring my decision on recusal until all the evidence was served, but this would cause practical listing difficulties and I can properly proceed, I think, on the basis that the evidence would not much affect my decision. It is more realistic to make it now.)"

556. Mr Benson QC contends that the impartial and fair minded observer must be deemed to have some legal knowledge by which he or she would be capable of understanding the distinction between the test to be applied in a decision in respect of an application for summary judgment and that to be applied in the substantive appeal.

5 557. In respect of the decisions on disclosure Mr Benson QC drew an analogy with a judge sitting in the Crown Court where decisions, such as that in respect of disclosure, are made regularly by a judge during the course of proceedings. In such circumstances Mr Benson QC submits that it is untenable to argue that a fair minded observer would believe that there was any real risk of perceived bias where such an order was refused.

10 558. As regards the Appellant's comments in respect of the *Ghosh* test applicable to the issue of dishonesty, Mr Benson QC submits that the objective part of that test is that which is commonly referred to as "*the reasonable man test*." The views of HMRC are irrelevant to the test and therefore the items of disclosure sought by the Appellant are also irrelevant.

15 **Discussion and Decision**

559. In reaching this decision I have carefully considered all of the submissions made by the parties and decisions to which this application relates, together with the authorities (including the decisions of Judge Berner and Judge Sinfield) to which I was referred and those contained in a bundle provided by HMRC. I also bore in mind
20 the Appellant's right under Article 6 to a fair trial by an independent and impartial tribunal.

560. It is a long established principle that public interest requires the avoidance of an appearance of bias. The test is an objective one and was set out *in Davidson v Scottish Ministers* [2004] SLT 895 in which Lord Bingham stated:

25 *"The question is whether the fair-minded and informed observer, having considered all the facts, would conclude that there was a real possibility that the tribunal was biased."*

561. I respectfully agree with and adopt the observations of Lord Justice Laws in the case of *Dr Sengupta* at [37]:

30 ***"Who is the fair-minded and informed observer?***

Our fair-minded and informed observer must surely have these matters in mind. That does not turn him into a notional lawyer. It merely reflects his fair-mindedness. However much we may in the name of public confidence be prepared to clothe our observer with a veil of ignorance, surely we should not
35 *attribute to him so pessimistic a view of his fellow-mans own fair-mindedness as to make him suppose that the latter cannot or may not change his mind when faced with a rational basis for doing so. That is, I think, what this case involves: not merely the ascription to the notional bystander of a putative opinion about the thought-processes of a judge, but the ascription of a view*

about how any thinking, reasonable person might conduct himself or herself when, in a professional setting, he or she is asked to depart from an earlier expressed opinion. The view which Miss O'Rourke submits should be ascribed to the bystander does much less than justice, I think, to the ordinary capacities of such a person. In my judgment, therefore, it is not a view which the fair-minded and informed observer would entertain."

562. I have concluded that the case of *Dar* is distinguishable from the appeal of Mr Butt not only for the fact that in the case of *Dar* the decision followed a hearing at which evidence was called but also for the robust findings of fact made on that evidence, in particular as to the credibility and honesty of the witnesses. Given Smith J's comment that: *"I have reached conclusions adverse to the claimants not only on some questions that might arise on the hearing of the committal application, but on issues that are likely to be crucial and possibly on all the real issues that will arise…"* one can in such circumstances understand his decision to recuse himself.

563. By contrast, in the application for summary judgment no evidence was called, no findings of fact made and I was cautious not to pre-judge the issues which fall to be determined in the context of the substantive appeal. The application was decided on the basis of Rule 8 of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, namely whether I was satisfied that the Respondent's case, or part of it, has no reasonable prospect of succeeding such that HMRC should be barred from taking further part in the proceedings. That this test was properly applied was confirmed by both Judge Berner and Judge Sinfield in their respective refusals for permission to appeal.

564. I should note at this point that in refusing the Appellant permission to appeal, there was no further consideration of the arguments raised by the Appellant but rather my refusal was based on whether there had been an error in law in the decision and whether the correct test had been applied; namely whether I considered that there is no reasonable prospect of the respondent's case, or part of it, succeeding.

565. I am also satisfied that circumstances set out in *Dr Sengupta* at [32] – [34] in which it was recognised that apparent bias is justifiably apprehended do not arise in this case (and I note that the parties made no suggestion otherwise.)

566. A distinction can also be drawn regarding the comments made in *Dr Sengupta* in respect of an *"ordinary case"* in which a judge sits on a substantive appeal having refused permission to appeal which is subsequently granted by another judge. To the extent that it is arguable that such a scenario would raise a real risk of perceived bias, I note the comments at paragraphs [38] and [39]:

"As I have indicated..Miss O'Rourke accepts that the bystander may be taken to possess "some knowledge of legal culture". He would know of the central place accorded to oral argument in our common law adversarial system. This I think is important, because oral argument is perhaps the most powerful force there is, in our legal process, to promote a change of mind by a judge. That judges in fact change their minds under the influence of oral argument is not

an arcane feature of the system; it is at the centre of it. Knowledge of it should, in my judgment, be attributed to the fair-minded and informed observer; otherwise the test for apparent bias is too far distant from reality. It is a commonplace for a hearing to start with a clear expression of view by the judge or judges, which may strongly favour one side; it would not cross the mind of counsel on the other side then to suggest that the judge should recuse himself; rather, he knows where he is, and the position he has to meet. He often meets it.

Another aspect of our legal culture is the expectations which the judges have of each other. Far from supposing that his fellow-judge would or might stand by an earlier view for no other reason that he had formed it, any judge would positively expect that his fellow would without cavil alter his view if he were objectively persuaded that it ought to be altered; and, to be blunt, would think much the worse of him if he would not. This too, it seems to me, would be known to the bystander."

567. I also note the comments of Keene LJ at [44]:

"What cases like Hauschildt do bring out is the need to see whether a judge is in reality having to decide the same question on which he has previously reached a determination... Initially, it seemed to me that it could be argued with some force that that was the situation which existed in the circumstances which this court is having to address. The decision in Thomann v. Switzerland could be explained on the basis that there the first trial was conducted in absentia, so that the court had not heard the defendant's side of the case at that stage, whereas on the retrial the court would be hearing his evidence and would therefore be dealing with a new factual situation. The same could not be said, at least not to the same degree, about the Court of Appeal procedure in England and Wales, where the single Lord Justice has considered on the papers the essential arguments being advanced on behalf of the applicant for permission to appeal and which would be advanced at any substantive appeal hearing.

However, on further consideration I have concluded that the nature of the decision being made by the single Lord Justice at that stage is sufficiently different from that required on the hearing of the substantive appeal for any allegation of an appearance of bias to be seen as unfounded. When making a decision on the papers whether or not to grant permission to appeal, the single Lord Justice is well aware that, though his decision may prove to be final, there exists the opportunity for the applicant to renew his application orally in open court. In other words, if the decision on the papers is not accepted, it can be reconsidered. In that sense, it remains, despite the change in the wording of the procedural rules, a potentially provisional decision."

568. In *Locabail (UK) Limited v Bayfield Properties Ltd* [2000] QB 451 the Court of Appeal said that:

"The mere fact that a judge, earlier in the same case or in a previous case, had commented adversely on a party or witness, or found the evidence of a party or witness to be unreliable, would not without more found a sustainable objection."

569. I reiterate the distinction between the authorities relied on by the Appellant and Mr Butt's appeal; the decision in the application for summary judgment was wholly based on whether I was satisfied that the Respondent's case, or part of it, has no reasonable prospect of succeeding. I am satisfied that that decision, the refusal of permission to appeal and the decisions in respect of disclosure did not go as far as to make any adverse findings or express any final views on the evidence, the Appellant's case or the live issues to be determined.

570. Similarly I am satisfied that the case management decisions taken in respect of applications for disclosure do not raise a real possibility of bias, real or perceived, such as to warrant recusal. Such decisions are regularly taken in appeals both prior to and during the course of proceedings. As regards the decision on disclosure in respect of which the Appellant sought leave to appeal from the Upper Tier, Judge Berner commented:

"Although expressed in terms of the FTT failing to have due regard to the matters raised, the application in substance amounts to nothing more than a complaint that the FTT was wrong. That is not enough to found an appeal on a point of law."

571. In those circumstances I am satisfied that the fact that the Appellant did not agree with the decision does not raise the risk of a perception of bias.

572. For the reasons set out above I am satisfied that the Appellant's application based on previous decisions has no sound basis and that the fair-minded and informed observer, having considered all the facts, would not conclude that there was a real possibility of bias. The application for my recusal is dismissed.

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

JENNIFER BLEWITT
TRIBUNAL JUDGE

RELEASE DATE: 13 OCTOBER 2015