

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009



ARUN CHAUHAN
JOINT HEAD,
FRAUD & ASSET
RECOVERY DEPARTMENT

About Challinors' Fraud & Asset Recovery Department:

- Jointly headed up by Arun Chauhan and Mark Kenkre
- Aimed at the commercial market
- One – if not the only – department of its kind in the Midlands and dedicated to dealing with commercial fraud cases
- The Department acts for government and other publicly funded bodies and corporate clients dealing with external and internal fraud issues
- The majority of specialist teams are based in London; Challinors believes in the need for this expertise in the Midlands
- The Department's central location provides for a more economic alternative to London, without forgoing expertise believed to exist only there.

The area of fraud:

- Fraud continues to be a growth area for many professions
- Remains a significant source of news, most recently for example, MG Rover and the proposed SFO investigation announced this week
- Everyone needs to be alert to the challenges it presents, for both commercial victims of fraud, but also innocent parties accused of fraud in the current economic climate
- The Department's service is both to assist investigation and recovery from fraud, and in establishing innocence.

Focus on VAT Fraud:

- In 2007 the International VAT Association estimated the annual cost of VAT fraud in Europe to be circa 100billion Euros
- The Office for National Statistics (ONS) reported: Suspected VAT 'missing trader' fraud activity rose 50 percent in the first quarter of the year 2009
- The quantity of fraud is now more than five times higher than a year ago, and the ONS says this is distorting UK trade figures
- Fraud has grown so fast that 10 percent of UK exports are now attributed to criminal activity which may involve no goods actually being exported at all
- This is alarming - the total recorded exports were £59.5bn in the January to March period
- VAT fraud centres on the assessment of payment for goods/services attracting input tax and the subsequent onward supply/sale of goods/services where output tax may/may not be charged
- Fraud investigations arise following detection of a series of transactions where a taxable individual incurs higher input tax than those set-off by output tax, which leads to reclaim of the difference from HMRC
- VAT fraud mainly focuses on Missing Trader Fraud, known as MTIC fraud.

Sham transactions:

- A lesser-appreciated fraud investigated by HMRC
- A sham is seen where an act undertaken or documents created, do not create the legal rights and obligations they give the appearance of creating
- To take effect, whilst there is a generalised view of common knowledge being in place for those involved in the sham, it's not always the case that every party involved in a transaction need know it is a sham

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

- A sham is likely to be used when seeking reclaim of input tax where a taxable individual has purchased goods, paying input tax, then has made onward sale, probably abroad, thereby not charging output tax, and the difference is reclaimed – HMRC will investigate if suspicious
- This presents a problem for innocent taxable parties – uncommercial transactions may be scrutinised and reclaims withheld on the basis of suspicion.

Case studies:

1. HMRC vs Plasma Trading Limited (No 2)

- Case centred on Plasma reclaiming input tax on purported purchases of platinum
- Tribunal were seeking to determine if the transactions were a sham
- Suspicion arose where Plasma had submitted a VAT return the end of Jan 2004, claiming repayment of £58,000
- The return submitted for period ending March 2004 claimed a repayment of more than £700,000 in respect of purported purchases of platinum that Plasma claimed to have exported to China
- Customs rejected the claim, believing the relevant transactions to be a sham
- Plasma appealed to the High Court, but was unsuccessful
- The evidence was scrutinised as the transactions appeared fraudulent and solely to obtain a large repayment of VAT, and the following were noted:
 - No evidence of extrinsic profit being made from the deals
 - The entire benefit appeared to be from the VAT reclaim sought and not from commercial profit
 - Goods exported were not platinum alloy
 - Plasma's website told a pack of lies about its commercial activities
 - Purchase invoices for platinum displayed the VAT number of British Gas!
- **Conclusion:** no evidence to demonstrate this was an innocent dupe caught up in someone else's fraud and that the purchase invoices were fabricated.

2. HMRC vs Dempster (2008)

- The trader, Dempster, reclaimed input tax for two purchases of substantial quantities of computer software from company Abacus Business Systems Ltd, which he then exported to a Canadian customer
 - Customs rejected the claim on the basis the transactions were a sham, that no supplies had been made to Dempster, and the documents did not convey what they intended
 - An appeal to the High Court was permitted, and noted:
 - Dempster had bought two consignments of computer software, which had been immediately exported
 - Genuine invoices existed for the purchase and sale, although there was little time between both transactions
 - Despite Dempster appearing to know very little about the commodity and that he had been tutored for a small role in a transaction, the sales had been prearranged before Dempster purchased the goods
 - To find the transactions were a sham would have involved finding Dempster guilty of some degree of fraud
 - **Conclusion:** no fraud on Dempster's part was found.
-
- Interesting that HMRC did not put to the trader that he was dishonest in cross examination – the implication being this was not believed, which makes the case slightly anomalous
 - HMRC did have to prove Dempster knew the documents failed to reflect the transaction – but HMRC failed to do so; the only exception would have been that he knew he was participating in tax fraud or wilfully turned a blind eye
 - The critical question – whether the rights and obligations expressed in the documents relevant for VAT purposes, are different from what the parties intended to confer or did incur.

CHALLINORS
SOLICITORS

FRAUD & ASSET
RECOVERY

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

Non-business expenses and false purchase invoices:

- Additional methods of VAT fraud, which may cause concern as they are not immediately detectable
- More common in the current economic climate
- Where input tax is incurred for a non-business expense, input tax cannot be reclaimed
- HMRC has to investigate the legitimacy of input tax claims
- Challinors has recently assisted in investigating a case where non-business expenses caused loss to customers of the party seeking to reclaim
- This occurred in an insolvency situation – where during what turned out to be the final 2-3 quarter returns, the reclaiming company (A) retained monies it claimed to have incurred as input tax against monies it received from its customer (B) when making onward supply of services
- A invoiced B for exaggerated and fraudulent charges. B paid the invoices and the VAT amount
- A sent their quarterly returns to HMRC accounting for their supply but retaining the difference between input and output tax for that quarter on account of expenses it incurred in provision of its services for B. B wanted to pursue A for the loss
- The fact that the expenses incurred included a box at Ascot (A provided commercial cleaning services!) a race horse and its upkeep, together with input tax incurred from associated companies of A, who had created false purchase invoices, would have no doubt led to HMRC disallowing reclaim for these items
- HMRC and B never got the chance to pursue their claims. Whilst A had started to explain why it had to incur what appeared to be non-essential expenses it entered into liquidation with the fraudulently retained VAT being dissipated by its officers.
- Unbeknown to B, it was being used to fund the fraud which A sought to legitimise through the VAT reclaim procedures which A had done for some time.

How Challinors can assist:

- The Fraud & Asset Recovery department is well placed to provide advice for both sides of the coin
- It has experience in investigating VAT fraud and is able to focus clients' attention on key documentation required when seeking to prove the innocence of a transaction.

Red Flags:

1. For the innocent party

- Ensure documents reflect transactions to which parties had agreed
- Show a history of dealing with the same trade
- Include contemporaneous documents – invoices, bank statements, delivery notes, shipping/freight documentation/foreign customs documents of customers receiving such goods
- Provide as much evidence as possible as to the chain of transactions with identities of parties involved etc.

2. For those investigating the fraud

- Verify all those documents identified for a party seeking to prove the innocence of a transaction – look at typefaces, stylistic matters of word processed documents
- Check all VAT numbers of all parties in a transaction
- Check-out VAT history of all officers of companies/sole traders etc involved in the chain
- Review peripheral information about the trader/taxable party – websites, previous history of trade, employees with a previous record (disqualified directors etc)
- Consider whether someone involved in the trade could really have overlooked the suspected fraud
- Ask others in the industry.

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009



MARK KENKRE
JOINT HEAD,
FRAUD & ASSET
RECOVERY DEPARTMENT

MTIC or Carousel Fraud:

- Under UK Law, a trader is entitled to set off input tax (purchases) against his output tax (sales)
- Where input tax exceeds output tax, he may reclaim the difference from the Revenue be that HMRC or Customs & Excise. This is deemed a right of deduction
- However, certain traders have sought to exploit this system using Carousel/MTIC schemes to defraud other companies and HMRC from substantial revenues
- It is estimated that fraud on the Revenue amounts to £3.5 to £4.74 billion per year
- Carousel/MTIC fraud often arises through contrived chains involving supplies of high value goods with the tax loss occurring when the VAT charged by the supplier is not paid to HMRC but can/is claimed by the recipient
- The most serious form of this fraud involves a series of transactions within and beyond the EU, allowing the same goods to be imported and exported many times with the aim of creating fraudulent VAT repayment claims.

Case Study:

- A typical fraud may begin with a VAT registered person (A) in the UK purchasing VAT-free goods from another EU Member State
- (A) will then arrange to sell the goods onto another business in the UK (B), charging them VAT on the sale
- (A) will then default on paying the VAT to HMRC and go missing
- (C) will purchase the goods from (B) and seek to re-export the goods to another EU Member State and seek repayment of their input tax from HMRC
- **Note:** There are normally a number of other businesses inserted into the chain between importer and exporter all accounting for VAT in the usual way in order to seek to disguise the fraud from HMRC. The trail is often long and complex in the hope that HMRC investigators:
 - Get lost in the chain of transactions
 - Decide it is uneconomic to be taken on any further
- The first example illustrates a "dirty chain", but often in an effort to avoid detection fraudsters seek to dovetail two chains of transactions, one being a "dirty chain" as detailed above, with the other being a "clean chain". This is commonly known as "contra-trading"
- The "dirty chain" begins with (A) who imports the goods into the UK. He sells them onto (B) who sells them onto (C) who exports them and is in a VAT reclaim position
- The "clean chain" begins with (C) who is the importer in this case. He sells it onto (D) who sells it onto (E) who exports it out of the EU. There are no defaulting traders and all traders in the chain properly account for VAT
- The effect of this "contra-trading" is that:
 - (A) will not pay any tax, but this will be disguised by the fact that they will not submit a return so HMRC will not know how much tax has been evaded.
 - (C) will have a tax-neutral position as his output tax liability in the "clean chain" will be cancelled out by his input tax credit in the "dirty chain".
 - (E) will be able to make an input tax reclaim from HMRC and it may be difficult for HMRC to prove that (E) knew or should have known of (A)'s fraud as it was on a separate chain. However, in this example, as (E) is the only beneficiary of the fraud by (A) then they must have known of the fraud.

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

Efforts of HMRC:

- In early 2006, HMRC developed criteria for undertaking 'extended verification' on certain repayment claims.
- This criteria worked so as to deny payment of any VAT repayment claim if two or more of the following applied:
 - (a) The repayment claim exceeded a certain amount;
 - (b) The trade was in a certain sector (mobile phones/computer chips)
 - (c) The trader had a connection with an MTIC fraud or a person involved in an MTIC fraud
- Upon confirmation that these criteria are satisfied, HMRC deny payment of the VAT reclaim until they have carried out extended verification
- Extended verification involves tracing the exported goods back through to the supplier and so on back to importation
- The reasoning behind this approach is to determine whether there is a missing trader in the chain
- If the extended verification process revealed the goods could be traced to a defaulting trader, HMRC would decide whether to deny the exporters input tax on the grounds they considered the trader knew or ought to have known it was participating in transactions connected to VAT fraud
- If HMRC determine the trader had the requisite knowledge, they inform the trader by letter that they are denying them the right to deduct VAT. The trader will then have the opportunity to consider an appeal to the VAT Tribunal.

Criticism of Extended Verification:

- The approach taken by HMRC has come under much criticism from traders, who feel HMRC are simply operating a blanket approach to extended verification which is catching as many innocent traders as those who are actively seeking to perpetrate fraud
- It is effectively wiping-out many traders who are not able to sustain their businesses without the cash flow of VAT repayments
- Traders feel the balance of power is unfair as HMRC are effectively able to withhold large sums of money without the need to prove a fraud has taken place or that a trader knew or ought to have known of the fraud
- However, HMRC say the results of this approach seem to be paying off: Recently the KPMG Fraud barometer reported that MTIC fraud had dropped from £700m in 2007 to £115m in 2008. HMRC point to their extended verification approach being key to this success.

In the Courts:

- HMRC has come under challenge from traders in the Courts for a number of years.
- The most recent development came with the much anticipated decision of Livewire Telecoms Limited.
- Livewire won its appeal against HMRC and the decision made by the VAT Tribunal which left HMRC having to pay all the £2.2m of VAT withheld under the extended verification procedure.
- The Court ruled that a legitimate trader in a "clean chain" (Livewire) could not have known of a future fraudulent transaction in a connected "dirty chain".
- This was followed at the end of May by the case of Blue Sphere Global Limited - the trader was once again successful in obtaining an order that HMRC repay nearly £1.5m in VAT withheld by HMRC.

Significance of the decisions:

- Could be potentially hugely significant as HMRC will have to prove that the trader knew or ought to have known of the fraud rather than the onus being on the trader.
- This will be an extremely costly and time-consuming process which will no doubt impact on the hundreds of claims that were awaiting the Livewire decision.
- It will be interesting to watch out for future developments in the area as the Courts seek to balance HMRCs extended verification process with the Courts traditional approach of putting the onus on HMRC to prove the trader knew or ought to have known of the fraud.

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009



JONATHAN LENNON

BARRISTER,
23 ESSEX STREET CHAMBERS

23es

23essexstreet

About 23 Essex Street:

- 23 Essex Street is one of the leading sets of Chambers in London
- It has a particular reputation for serious and organised crime, fraud and financial crime on a national and international level
- Jonathan Lennon has particular experience of dealing with VAT fraud cases often involving organised crime.

Input VAT in alleged MTIC cases: Tax Chamber, High Court & European Court of Justice – some Case Law:

1. [Optigen Ltd; Fulcrum Electronics; Bond House v Customs & Excise Commissioners \[2006\] STC 419 ECJ 12/1/06](#)

- HMRC refused input VAT in each of these cases. Upheld by VAT & Duties Tribunal and led to appeal to High Court in 2003 which led to reference to ECJ on interpretation of First Council Directive 67/227 Art 2 and the 6th Directive 77/388 Art 2(1), Art 4 and Art 5(1).¹

- ASSUMED FACT: Optigen etc. innocent traders – brokers at end of “dirty chains”.
- ECJ confirmed that the 6th Directive authorised measures to combat VAT – UK introduced s77A to the Value Added Tax Act 1994 which imposes joint and several liability where a taxable person “knew or had reasonable grounds to suspect” that some or all of the VAT payable on a transaction or previous transaction would go unpaid.
- HMRC argument: transactions involving MTIC frauds were not genuine economic activity under EU law & therefore customs were entitled to withhold input VAT payments. Global approach.
- This represented the first line of attack by HMRC on MTIC frauds.
- ECJ held that each transaction in the chain had to be examined on its own merits and that a transaction that was not itself vitiated by fraud constituted a supply of goods or services effected by a taxable person acting as such, and an economic activity:
- Para 51 of judgment:

It follows that transactions such as those at issue, 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.

- Thus need to concentrate on links in the chain and not simply totality of overall picture.

2. [Kittel v Belgium & Belgium v Recoulta.ECJ 6/7/06](#)

- KITTEL: Knowing party to a VAT fraud.

- ECJ HELD: given finding of actual knowledge the State could deprive tax payer of its right to deduct input tax.

¹ The provisions re VAT, originated in the 1st Council Directive of 11/4/67, then the 6th Council Directive & are now contained in Council Directive 2006/112/EC of 28/11/06. The Value Added Tax Act 1994 is the relevant statutory implementation by the United Kingdom.

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

- RECOULTA: Innocent trader – para 51:

"In the light of the foregoing, 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, Customs and Excise Comrs v Federation of Technological Industries (Case C-384/04), para 33)."

- By contrast, para 61:

"By contrast, 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."

3. *Dragon Futures Ltd v Revenue & Customs Commissioners*. VAT & Duties Tribunal Oct 2006 (19831).

- Preliminary issues for Tribunal – main question was meaning of the test in *OPTIGEN AND KITTEL* – i.e. meaning of MEANS OF KNOWLEDGE.
- Agreed that the applicable test had to be objective.

- HMRC submitted: only repay input VAT to those who were "wholly innocent" – this was rejected.

- The Tribunal set out a number of criteria:

- Actual knowledge and actions taken or not taken to acquire knowledge – hindsight was irrelevant.

- Test can take into account but cannot be dictated by guidance offered by HMRC (e.g. Notice 726) – however a trader who ignores guidance from HMRC may be deemed to have constructive knowledge of the fraud.

- The taxable person must make a proportionate response to information actually known that indicates fraud. Knowledge is not restricted to the immediate supplier/purchaser – includes knowledge of the market.

- The taxable person must take proportionate steps to use all means reasonably available to increase actual knowledge. This could include checks on validity of VAT registration numbers, checks on customs stamps on goods going through a customs inspection, checks with credit agencies and inspection agencies, including checks on the IMEI numbers of telephones, and the use of appropriate terms of contract.

- Whether the steps are proportionate must be a question of fact in each individual case. There can be no presumption that because fraud existed in a chain then that fraud is known, or should have been known, to all others in that chain.

- The Tribunal found that the *Kittel* "knowledge" test was as follows (para 75):

"Has the taxable person, at the time of entering a transaction involving payment of value added tax by or to that person, and taking into account the actual knowledge of the taxable person at the time (including knowledge acquired from any enquiry or investigation), taken all proportionate steps available to it to ensure that, on the balance of probabilities, no aspect of the transaction is connected with any other party involved in, or any other transaction involving, fraud on the public revenue through the value added tax system?"

- NOTICE 726

- Warnings; such as does deal offer no commercial risks?

- Also questions; do you know supplier/customer, met senior officer of the supplier, are you keeping all records, invoices CMRs etc?

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

CONTRA-TRADING

4. R (Just Fabulous (UK) Ltd); R (Evolution Export Trading Ltd and Greystone Ltd); R (Brayfal Ltd) v HMRC [2007] EWHC 521 (Admin). 15/3/07

- Three joined cases in Judicial Review. All mobile phone traders.
- All of these companies were involved in one way or another with contra-traders.
- One of the arguments by the Claimants' was that the Kittel case only legitimises a refusal by the Revenue to pay VAT due in respect of the goods that are the subject matter of the defaulter chain.
- HMRC submitted (para 41): that the contra-trading method of sidestepping the need for the exporter to put in a tax reclaim direct to the Revenue, and thus recovering VAT, otherwise non-recoverable direct from the Revenue, by "laundering" it into a contra-trade, had not been thought of at the time of the facts underlying Kittel: indeed to an extent it could be said that it has only become necessary as a result of the legitimisation by Kittel of the action by the Revenue.
- HELD: The Revenue was simply exercising a right, sanctioned by Kittel, to refuse payment of a return apparently in credit, by reference to the contra-trade transaction, which has been used impermissibly to pay off the VAT.
- This supported an earlier Tribunal decision in January 2007: Calltel Telcom Ltd; Opto Telelinks (Europe) Ltd v HMRC.

5. Commr for HM Rev & Customs v Livewire Telecom Ltd; Comm for HMRC v Olympia Technology Ltd [2009] EWHC 15 (Ch). (16/1/09)

- Very important case. Lewison J.
- Clarifies the evidential burdens which need to be discharged by the Commissioners of HM Revenue & Customs (HMRC).
- LIVEWIRE = ultimate exporter in clean chain (contra)
- OLYMPIA = ultimate exporter in a dirty chain (re most exports there were 3 clean chain exports too).
- QUESTION OF LAW: in what circumstances may HMRC lawfully refuse to make payment of input VAT to an exporter who is not himself dishonest AND does not have actual knowledge of a scheme to defraud the Revenue?
- SUBMITTED by Livewire & Olympia that KITTEL laid down a test of dishonesty.
- Rejected by Court (para 85) because requirement to act with all due diligence and care (see e.g. the AG's decision in the Netto case 21/2/08) - incompatible with a simple test of dishonesty.
- Policy is that an honest AND careful trader should not be liable for the frauds of others (para 84).

WHAT IS THE DUTY?

- Is there a positive duty on the trader?
- No. (para 87) Duty to take every reasonable precaution does not impose a duty to take precautions,
- BUT: taking of all precautions (and acting on the basis of what he discovers as a result of taking those precautions) provides him with an impenetrable shield against any attack by HMRC
- HMRC submitted (para 88) that if do not take every reasonable precaution expected then should automatically follow that forfeit right to deduct input tax.
- REJECTED: "In my judgment..... if a taxable person has not taken every precaution that could reasonably be expected of him, he will still not forfeit his right to deduct input tax in

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

a case where he would not have discovered the connection with fraud even if he had taken those precautions.”

CONSTRUCTIVE KNOWLEDGE

- Tribunal: had applied subjective test of what the particular Director knew or ought to have known.
- Rejected by High Court (para 123);
The question therefore for the Tribunal was not what a director of Olympia knew or ought to have known, but what the company itself knew or ought to have known.....Accordingly, in applying the test of what ought to have been known by a director with the knowledge, skill and experience of the particular director concerned the Tribunal, in my judgment, fell into a legal error.
- And at para 125:
Knowledge that should be attributable to senior employees is relevant too.

I consider that the Tribunal was wrong to water down the requirement that the taxable person must take every precaution reasonably required. The test does not require the person must take every precaution reasonably required. The test does not require the taxable person to take every possible precaution: merely every precaution reasonably required. This test gives the Tribunal sufficient flexibility to decide, on particular facts, that a suggested precaution would have gone beyond what could reasonably have been expected.

- Court favoured Nelsonian knowledge – i.e. constructive knowledge/constructive notice approach: be taken to know what a reasonable man would have known.

WHAT ABOUT 'KNOWLEDGE' IN CONTRA-TRADING CASES?

- Tribunal found that in contra-trading cases, for HMRC to be successful they had to show that the trader knew of both dirty chain and clean chain.
- HIGH COURT: In the 'real world' in contra-trading cases what is it that the trade should have known (para 92)?
- Para 102:
Contra-fraud = Two potential frauds; 1) dishonest failure to account for VAT by defaulter on dirty chain and 2) dishonest cover-up of that fraud by the contra-trade.
- Para 103:
Thus it must be established that the taxable person knew or should have known of a connection between his own transaction and at least one of those frauds. I do not consider that it is necessary that he knew or should have known of a connection between his own transaction and both of these frauds. If he knows or should have known that the contra-trader is engaging in fraudulent conduct and deals with him, he takes the risk of participating in a fraud, the precise details of which he does not and cannot know.
- Para 116:
For the reasons I have given, I consider that this was too high a legal test. In the case where the contra-trader is himself a dishonest co-conspirator it need not be shown that the taxable person knew or ought to have known of the missing trader's default. It is sufficient if he knew or ought to have known of the contra-trader's dishonesty. In a case where the contra-trader was not dishonest, it is sufficient if the taxable person knew or ought to have known of the missing trader's default.
- The High Court has said in effect that in contra-trading cases, HMRC will have to show that the alleged contra-trader is a party to a conspiracy involving the defaulting trader.
- Conspiracies are difficult to prove, and those involving alleged co-conspirators who are separated by numerous members of not one but two, apparently unconnected, transaction chains even more so.

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

6. Mobilx Ltd (In Administration) v Revenue & Customs Commr [2009] EWHC 133 (Ch) 3/2/09

- Appeal from the Manchester VAT Tribunal that went the other way. Floyd J.
- Mobilx lost at Tribunal – the following facts were found:
 - Directors had been deliberately dishonest in stating to the Commissioners that they intended to trade in mobile phones – moved to CPUs.
 - Directors had given no thought to how it could be possible for them to make such large profits in such a short period of time & they wilfully ignored possibility of such instant wealth being probably the result of fraud.
 - Been warned by HMRC that every one of their transaction chains during the previous year had been tainted by VAT fraud – continued to trade.
- APPEAL DISMISSED: Criticisms that HMRC's case had escalated at trial. Further there was a difference between lack of candour and deliberate deceit – the tribunal was not entitled to make an adverse finding against M because of move from phones to CPUs.
- BUT: on the evidence, the Tribunal was entitled to find that M should have known, on the balance of probabilities, that all transactions were leading back to defaulting traders. Due diligence on immediate suppliers might be all that could be done but where chains were consistently being identified as 'dirty' more drastic action would be required – a reasonable and proportionate response would be to either radically alter their method of trading or get out of it altogether. M did not do either.
- Tribunal decision upheld.

7. Blue Sphere Global Ltd v Revenue & Customs Comm [2009] EWHC 1150 (Ch) 22/5/09

- Chancellor Morrit J. Reversed decision of Tribunal upholding Customs decision.
- Another contra-trading case.
- BSG bought mobile phones from company called INFINITY.
- HMRC's Statement of Case said INFINITY was a contra-trader. Deals with BSG = clean chain but the clean chain crossed INFINITY's dirty chain trades.
- It was alleged BSG knew or should have known that, it was involved in "transactions which might turn out to have undesirable associations..."
- TRIBUNAL HELD: Found in favour of HMRC
Rejected any allegation of conspiracy involving BSG or that BSG had been manipulated by others. It 'acquitted' INFINITY of fraud.
But held that BSG had failed to make full enquiries and investigations in advance of the deal. Held that if it had done so the answers would have revealed the "uncommercial features of the deals" and therefore BSG "ought to have known". The enquiries carried out by BSG were: "not sufficient to protect BSG from the risk of involvement in transactions which might turn out to have undesirable associations." para 162.
- HIGH COURT HELD: Test was incorrect and misleading:
Burden on HMRC to prove that BSG ought to have known that by its purchases it was participating in transactions connected with fraud. Not for BSG to prove that it ought not. Not sufficient to demonstrate that BSG involved in transactions which "might" turn out to have undesirable associations. Relevant knowledge is that BSG ought to have known that by its purchases it was participating in transactions which were connected with the fraud; that such transactions might be so connected is not enough.
- Para 54:
If Infinity did not know of the fraud when it happened and was not party to any arrangement that it should happen, how could BSG have known of any fraud before it happened? No amount of due diligence undertaken in respect of Infinity, Universal or Allimpex could have revealed it. And if BSG could not have known, how could there be circumstances from which it could properly be concluded that BSG ought to have known?
- This Ruling suggests that HMRC will have to show that in an alleged contra-trader case, the contra-trader is a party to a conspiracy involving the defaulting trader.

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**

SPEAKERS' NOTES

VAT FRAUD SEMINAR, 9TH JULY 2009

What about the European Convention on Human Rights?

- First Tier, Tribunal decision of 18/5/09 (London):
- S&I Electronics v Commissioners for HMRC [2009] UKFTT 108(TC).
- Considered application of Bulves v Bulgaria [2009] ECHR 143.
- Bulgarian State refused to credit input VAT.
- At time Bulgaria not EU member.
- Challenge therefore to Strasbourg ECtHR.
- Article 1 of the First Protocol to the Convention:
- Article 1 of Protocol No. 1 reads as follows:
"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

- ECHR held that State had violated the Article 1, 1st Protocol right.
- Very much on its own facts but possible further emerging area of argument – not followed in S&I but only on factual basis.

Tribunal:

- New structure from 1st April 2009. Tribunals, Courts & Enforcement Act 2007. Creates: The Tribunal Procedure (First-Tier Tribunal) (Tax Chamber) Rules 2009.
- 4 Tribunals replaced by a single Two-Tier system composed of the TAX CHAMBER in the First Tier Tribunal
- Appeal (with permission) to new Finance & Tax Chamber in the Upper Tribunal. From there appeal lies with Court of Appeal.

Costs (r10):

- Tribunal has power to award costs against losing party but will only happen rarely where tribunal considers that one of the parties has acted unreasonably or a case was categorised as 'complex' (r23) and appellant chosen not to opt out of any potential costs regime within 28 days.

N.B. 4 categories of cases: Default Paper, Basic, Standard and Complex.

IF YOU WOULD LIKE MORE INFORMATION ON OUR FRAUD AND ASSET RECOVERY SERVICES, PLEASE CONTACT:

Arun Chauhan

Joint Head of Fraud and Asset Recovery Department

T: 0121 204 2666

E: arun.chauhan@fraud.challinors.co.uk

Mark Kenkre

Joint Head of Fraud and Asset Recovery Department

T: 0121 204 2665

E: mark.kenkre@fraud.challinors.co.uk

Edmund House 12-22 Newhall Street, Birmingham B3 3EF

T: 0121 212 9393 F: 0121 212 3422 E: enquiries@fraud.challinors.co.uk

<http://fraud.challinors.co.uk>

WE WOULD LIKE TO THANK OUR GUEST SPEAKER:

Jonathan Lennon, Barrister 23 Essex Street Chambers, London, WC2R 3AA

T: 020 7413 0353 E: JonathanLennon@23es.com W: www.23es.com

CHALLINORS
SOLICITORS

**FRAUD & ASSET
RECOVERY**