Recovery of input VAT – scrap metal trade – were the limbs of the Kittel test met?

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2015/06501

BETWEEN

RONALD HULL JUNIOR LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE SARAH ALLATT
MR MOHAMMED FAROOQ

Sitting in public at Rolls Building on 7-17 October 2019

Mr Michael Firth for the Appellant

Mr Nicholas Chapman, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This is an appeal about fraudulent evasion of VAT in the scrap metal trade.

THE APPEAL

2. The Appellant, Ronald Hull Junior Ltd (RHJ) is appealing against HMRC's decision to deny it the entitlement to credit for input tax in an aggregate sum of £597,172.00.

3. The appealed decision relates to 389 transactions covering 3 quarterly VAT periods:

4. 07/13: £68,516.00, 10/13: £283,817.00, 01/14: £244,839.00

5. The disputed transactions relate to purchases from two different suppliers. The vast majority are purchases from Barnsley Metal Company Ltd (BMC). A small number of purchases are from Carwood Commodities Limited (CCL).

BACKGROUND

6. It is convenient to set out some background to the facts in the case.

7. RHJ was started by Ronald Hull in 1976, and Mr Hull is still the Managing Director of the company. The company has grown from small beginnings and now employs over 200 people. The group is divided into a number of different divisions and this appeal is concerned with the non-ferrous metal division. Terry Hartley was, at the relevant time, in charge of metal trading in this division and had worked for RHJ for over 22 years. Karen Greaseley is Group Financial Accountant for the company.

8. RHJ purchases from a large number of suppliers. We were not given an exact number but a total number of around 3000 suppliers and customers was mentioned by the Appellant and not challenged by HMRC.

9. Suppliers may contact the appellant for a quote, or RHJ may approach potential suppliers regard materials they may have for sale or may accumulate as part of their normal business.

10. RHJ does not have contracts with suppliers. Business is agreed either by quoting a price per tonne of the metal in question, or by valuing a load that is brought into the yard. RHJ pays for the metal when the metal is brought in (usually by BACS).

11. RHJ Ltd was denied VAT in relation to purchases two of its suppliers: BMC and CCL.

THE TRANSACTIONS

12. During its 07/13, 10/13 and 01/14 quarterly VAT periods, the Appellant purchased goods in a total of 8,084 transactions to a total net value of £21,339,520.

13. HMRC have denied input tax to RHJ on 389 of these transactions.

14. In the vast majority of the transactions in issue– 383 of the 389 transactions– the Appellant's supplier was BMC. These purchases from BMC had a total net value of £2,607,757.07, representing 14% of the Appellant's purchases, by value, over the 3 VAT periods in question. BMC was the Appellant's biggest supplier by value in the Appellant's accounting year ending 31 January 2014.

15. HMRC allege that BMC was a fraudulent defaulting trader. It failed to account for or pay to HMRC the VAT corresponding to any of these 383 sales to the Appellant. It failed to file a VAT return or account for or pay any VAT at all in respect of its (corresponding) 08/13, 11/13 and (final) 99/99 VAT periods.

16. In respect of the remaining 6 transactions (out of the 389 in issue), the Appellant's supplier was CCL. These 6 transactions had a total net value of £378,110.70, which represented a little under 2% of the Appellant's purchases, by value, over the 3 VAT periods in question. (These transactions took place in July and August 2013 only).

17. HMRC allege that in each of these 6 transactions, CCL was supplied by GPSE, who HMRC allege is a fraudulent defaulting trader.

18. GPSE failed to account for or pay to HMRC VAT corresponding to any of these transactions. It failed to file a VAT return or account for or pay any VAT at all in respect of its corresponding (final, 99/99) VAT period.

THE APPEAL

19. The Appellant raises a number of grounds of appeal. It submits that firstly, the decision/assessment was not competent. Secondly, it submits that the assessment was not made to best judgement. Thirdly, in relation to the CCL transactions it submits that HMRC has not proved fraud by GPSE, and in relation to BMC transactions that HMRC have not proved fraud by BMC. Fourthly, it submits that there has been no connection proved between GPSE's transactions with CCL and CCL's transactions with RHJ. Lastly, it submits there was no actual knowledge or means of knowledge of fraud (either in relation to BMC transactions or in relation to CCL transactions).

EVIDENCE ON BEHALF OF HMRC

Evidence from Mr Payne – mainly in relation to the Appellant

20. We heard from Mr Robert Payne of HMRC. Unfortunately, both the preparation and the checking of the witness statements of Mr Payne lacked rigour. The witness statements were prone to exaggeration and were shown to contain errors, in some cases quite basic errors.

21. Mr Payne produced three witness statements and gave oral evidence. Mr Payne had conducted a number of site visits to Ronald Hull Junior, and was the allocated officer for Ronald Hull Junior from November 2013. Mr Payne was the decision making officer who issued the decision to deny the input tax claimed by Ronald Hull Junior in the 07/13, 11/13 and 01/14 VAT periods.

22. Contemporaneous visit reports by Mr Payne showed that his initial impression of Ronald Hull Junior was very favourable. For example, he wrote "It would seem that at the moment Ron Hull Jr are 'out' of the midst of the MTIC fraud chains and talk like a company who are clean and have no time for the people who get involved. They are clearly very aware of the issues surrounding MTIC fraud and have had several visits over the last few years at which it and aspects of it (invalid invoices) has been discussed with HMRC officers both MTIC and otherwise. It is entirely possible of course that they could at any moment start buying from businesses with fraudulent intent however they appear to carry out rigorous due diligence checks in order to avoid such occurrences and a watching brief is advised accordingly."

23. After another visit, he wrote "Ron Hull and his fellow directors are clearly passionate and protective of their business and are frustrated/angry that they are having to go the extra mile re due diligence etc but appear to understand the reasons why. This is a long standing business which-is clearly processing and recycling on a large scale. They don't appear to 'back-to-back' trade and the vast majority of stock purchased is subject to checking, processing and stockpiling prior to its onward sale. Upon receiving the CCL tax loss letter they reacted quickly and decisively by ceasing all trade with them even though they are not happy at having to do so."

24. By the time of his second witness statement, Mr Payne had changed his view of the due diligence performed by RHJ from 'rigorous' to 'perfunctory'.

25. Under cross-examination, Mr Payne first said that the reason for the change of mind was because his first opinion was on the basis of what the RHJ employees said, rather than seeing an example of what they actually did. However, Mr Payne was shown a visit report where it was clear he had been handed an example of the due diligence that RHJ requested from suppliers. Mr Payne then said he was not sure whether he had actually looked at the due diligence pack when it was handed to him.

26. When asked to explain what he meant by 'perfunctory' Mr Payne first said that the due diligence was 'standard' and then that it was 'what was outlined in the notice' [Notice 726]. Upon further questioning, Mr Payne said that he would expect due diligence to include third party checks, such as credit checks or checks on information held by Companies House.

27. Mr Payne produced his second statement in response to witness statements by the Appellant's witnesses. The impression his witness statement gives is that he wants to discredit the Appellant's witnesses but under cross examination many of Mr Payne's criticisms of the Appellant's witness statements are not borne out.

28. For example, in his second witness statement, Mr Payne wrote 'Mr Hartley states that *'sometimes I would visit the supplier to inspect the load before it was delivered.'* He does not state which suppliers he visited. I have spoken to Mr Hartley on numerous occasions about the deals with BMC and CCL and he never intimated that he had inspected a load at their premises. I believe that if this had occurred, it would have been mentioned during one of the discussions we had about the transaction process. I have seen no evidence that any such visit took place, nor any evidence of any price renegotiation following any such visit.'

29. Mr Payne was then taken, in cross examination, to a visit report and a letter from the Appellant saying specifically that site visits had taken place at BMC to inspect goods.

30. A large part of the second witness statement is taken up detailing an investigation Mr Payne had conducted into pricing. The basis for the statements made was erroneous and has been withdrawn. However the Tribunal is surprised that it ever went into the witness statement because the conclusions it drew were so surprising that they should have been checked at an early stage.

31. In the second witness statement, in response to Mr Hartley producing, in evidence to his first witness statement, invoices showing RHJ trading with CCL before 2010, Mr Payne wrote 'I note Mr Hartley's comment at paragraph 58 that it was wrong for me to say that trade with CCL began in 2010. At paragraph 59 of my first statement, I refer to the full CCL purchase ledger document provided to me by the Appellant which shows the first transaction/ invoice date as 31 July 2010. I have seen no evidence of any earlier trading.' Given that Mr Harley had, at the relevant paragraph, detailed the evidence attached to his witness statement, which did indeed show earlier trading, this statement is either deliberately false, or shows extreme lack of care in preparation of the witness statement.

32. Relevant points from Mr Payne's witness statement are as follows:

33. During 2007 enquiries were made by Officer Stephenson and Officer Day in relation to some of RHJ's suppliers with whom the Appellant operated 'Self-Billing'. Self-Billing is an arrangement between a supplier and customer, whereby the customer prepares the supplier's invoice and forwards a copy to the supplier with payment. This enables the customer to reclaim input on the next VAT return. The biggest VAT risk associated with Self Billing involves a supplier to a scrapdealer going missing before submitting its own VAT return and declaring tax on sales. By letter dated 9 January 2007 Officer Stephenson informed the Appellant that its supplier Fellowbrook Ltd was no longer allowed to self bill to the Appellant using the Self-Billing system.

34. On 28 May 2008 Officer Nigel Ward carried out the first MTIC team visit to the Appellant accompanied by Officer Emma Raglan. The purpose of this visit was to verify a transaction it had carried out with its customer AL Resources. Officer Ward spoke to Ron Hull and David Holmes (Financial Accountant) for most of the visit about MTIC fraud in general. Ron Hull stated that RHJ only do credit checks on customers because they are the only ones who are going to pay them. Officer Ward suggested that Ron Hull undertake further checks on any new potential suppliers and customers as there are more unscrupulous people entering the trade. Ron Hull indicated that he agreed. The Tribunal notes that it is not clear, either from the visit reports or from oral evidence, what Mr Hull was agreeing with here. He could have been agreeing that RHJ should/would undertake checks on future new suppliers, or he could have been agreeing that more unscrupulous people are entering the trade, or both.

35. At a visit on 31 August 2010 Officer Charles advised Ms Greasley of the need to carry out due diligence checks on its suppliers. Ms Greasley told Officer Charles that the business undertook credit checks on its suppliers in addition to VAT number verifications. She further stated that where RHJ receives notifications from HMRC relating to the cancellation of a supplier's VAT number, RHJ stops trading with it. The Tribunal notes that Ms Greaseley disputes that she said that the business did credit checks on suppliers (see her witness evidence below).

36. On 26 March 2012 Officer Emma Raglan carried out a visit to the Appellant's trading premises accompanied by Officer Tiffany Renshaw. They spoke to Ms Greasley, Ron Hull and a lady introduced as 'Katrina' whom Officers Raglan and Renshaw were advised was responsible for undertaking and collating the due diiigence checks and also works within the cash office, dealing with VAT. During the visit MTIC fraud and due diligence procedures were discussed in detail.

37. Emma Raglan's visit report stated 'I asked how often the due diligence checks are undertaken. Katrina advised that once the client is accepted and set up, they review the checks on a yearly basis (every September). She asked if that was enough. I explained that I can't give a definitive answer on this and suggested that they review the checks when they feel it is necessary such as if the trading pattern changes eg the size of the deal undertaken increases massively.'

38. 4 April 2013 Mr Payne carried out a visit to the Appellant's trading premises, accompanied by Officer Emma Raglan. The meeting was attended by Karen Greasley, Ron Hull and Terry Hartley. They discussed at length MTIC fraud and its effect upon the scrap metal trade sector. Mr Payne advised them of the need to carry out effective due diligence checks and the need to retain evidence to show that such checks had been carried out. Mr Hartley asked whether a VAT number verification by the Wigan VAT number validation team meant they were 'in the clear'. Mr Payne's response was to say that HMRC want to see a 'basket of evidence' in terms of checks having been carried out on suppliers and not simply a Wigan check. He also handed the Appellant a copy of Public Notice 726 and the 2007 Statement of Practice regarding invalid invoices and explained each. They expressed their concerns about the extra resources which carrying out such checks required and that it was burdensome to the business. Mr Payne formed the view that they understood the issues surrounding MTIC fraud very well and were aware of the types of due diligence checks that were necessary to avoid involvement in MTIC fraud.

39. Later in Mr Payne's witness statement he makes a number of statements about due diligence that RHJ could have done on various Cooper companies and on CCL. Unfortunately a number of the assertions he makes are either inaccurate or irrelevant.

40. For example, he states that the accounts for BMC 30/04/2012 were filed late when this was not the case. He refers to accounts for BMC for the period to 30/4/2014 when these are

clearly not relevant to due diligence in 2013. He refers to the accounts for Towmasters showing a net liability position, when this is for accounts filed after April 2013 and so not relevant for any due diligence RHJ could have done at the relevant time.

Evidence from Mrs Martin (formerly Ms Raglan) in relation to BMC and associated companies

41. The tribunal heard from Mrs Emma Martin of HMRC in relation to BMC. Mrs Martin was a straightforward and truthful witness.

42. BMC made supplies to RHJ during the relevant periods 07/13, 10/13 and 01/14. BMC did not submit a VAT return for their periods 08/13 and 11/13 did not account for VAT to HMRC for tax due on its sales in these periods. BMC is therefore a defaulting trader.

43. Mrs Martin's witness statement set out the history of the director of BMC (Chris Cooper) and his family. Chris Cooper has a long history of trading within the scrap metal industry. He has a son (Craig Cooper) and a daughter (Colette Laite) both of whom have owned/worked for other scrap metal businesses as well as BMC.

44. HMRC wish to show that the history of these companies is that of a company that trades for a period of time, enters voluntary or compulsory liquidation with a VAT debt owing, and either concurrently or after a short period of time a business, alleged to be the same business, is operated within a different company.

45. Mrs Martin's witness statement therefore gave a brief history of a number of these companies.

Coombehill Ltd

46. Craig Cooper and Chris Cooper were the directors of a company called Coombehill Ltd. This company had applied to be registered for VAT with a main business activity of property letting. After the first VAT return Coombehill failed to submit any other VAT returns. At an HMRC visit in January 2006 it was discovered that the company was actually buying and selling scrap metal and there were no physical premises for Coombehill Ltd at the registered address. During a telephone with the accountants of Coombehill Ltd HMRC were informed the company had been sold in April 2004. After the visit in January 2006 Craig Cooper telephoned HMRC and HMRC requested Coombehill's accounts. Mr Cooper did not provide HMRC with any requested documentation and did not return any of HMRC subsequent calls and the company entered into compulsory liquidation on the 22 November 2006.

Fellowbrook Ltd

47. Craig Cooper was a director of Fellowbrook Ltd. The company traded from January 1996 until September 2009. The Company had originally applied to be registered for VAT indicating a main business activity of road haulage however by the time of a visit by HMRC in January 2007 it was clear that the company was buying and selling scrap metal. The company entered compulsory liquidation on August 2009 owing a VAT debt of £5.7 million.

48. In March 2009 Craig Cooper was disqualified from being a director for 7 years as a result of his conduct as a director of Fellowbrook Ltd.

Brecks (Holdings) Ltd

49. Craig Cooper was also the director of a company called Brecks (Holdings) Ltd that appears to have been acquired by the Cooper family in 2005. During a visit to Fellowbrook HMRC was told by Fellowbrook's accountant that Brecks (Holdings) Ltd had taken over the trading activities of Fellowbrook. Brecks (Holdings) Ltd entered compulsory liquidation in July 2010 with a final VAT debt owing of over £700,000. It is HMRC's understanding that all trading in relation to Brecks (Holdings) Ltd was transferred to Towmasters Metals Ltd, another company owned by the Cooper family.

Towmasters Metals Ltd

50. Towmasters Metals Ltd traded from December 2005 until July 2013. Chris Cooper was a director. In June 2009 Chris Cooper sent a letter to HMRC informing HMRC that Towmasters was trading in metal. HMRC issued a letter in September 2009 advising of the risk of MTIC fraud within the scrap metal trade sector. In February 2010 MTIC officers met with Chris Cooper and discussed MTIC fraud in relation to the scrap metal industry and explained Wigan validation checks.

51. The company was selected for MTIC monitoring and regular meetings were conducted. Tax loss letters were issued regarding purchases made from two suppliers. In April 2012 HMRC officers were informed by Chris Cooper that the police had raided the Towmasters premises and seized the company's business records and computers. At a visit in February 2013 HMRC were concerned that Towmasters Metals Ltd and BMC were trading from the same premises and HMRC anticipated that BMC would take over the business of Towmasters as HMRC were also aware that BMC had a checked the VAT registration numbers of the suppliers and customers of Towmasters. In July 2013 Towmasters submitted an application to deregister for VAT . The company was subsequently deregistered and entered a creditor's liquidation in October 2013.

52. WM Darley's Properties Ltd traded from July 2011 until April 2015. Chris Cooper was the director. Mrs Martin was the allocated MTIC monitoring officer for this company. Mrs Martin told us that at a visit on February 2014 Mr Cooper was giving education relating to MTIC fraud and issued with public notice 726. Mrs Martin noted after the visit in February 2014 that the company presented to general risk to VAT because Mr Cooper was facing charges under money laundering regulations and the accounts and administrative side of the business had previously been managed by an accountant who was imprisoned for fraudulent activities. In addition the company had recently taken over the activities of BMC who HMRC noted were a defaulting trade with a history of non-compliance. In March 2015 HMRC received an application to deregister a company and the company ceased trading from 7th of April 2015. The company entered a creditors voluntary liquidation on 30th of April 2015.

The Cooper family and associates

53. Chris Cooper made a disqualification undertaking in April 2016 under section 7 of the Company Directors Disqualification Act 1986. By that undertaking he was disqualified from acting as a director of any company for a period of 13 years starting on 18th of May 2016.

54. Chris Cooper was sentenced to 12 months imprisonment on July 2016 in relation to his directorship of Towmasters Ltd.

55. Mike Howley was the accountant for BMC, and was company secretary of Coombehill Ltd, Brecks Holdings Ltd, Fellowbrooke Ltd and Towmasters Ltd. He was sentenced on 12th of March 2014 to 4 years imprisonment having been convicted of money laundering offences.

56. Craig Cooper was disqualified as a director for 7 years from the 12th of March 2009 as a result of his conduct as a director of Fellowbrook Limited.

BMC

57. We heard from Mrs Martin about HMRC contact with BMC over the period of time 2010 to 2014. The pertinent points of the evidence are as follows:

58. HMRC had contact both with the director of BMC (Chris Cooper) and with accountants of BMC who were AST Green.

59. In November 2012 HMRC detected errors in the VAT return for BMC and issued a penalty.

60. In April 2013 HMRC officers visited BMC due to a dramatic increase in sales and purchases. Chris Cooper stated that the BMC yard was shared with Towmasters and that BMC had been trading there for approximately 18 months. He explained that he had acquired BMC roughly 18 months previously and that the business has been in a lot of debt but the reason for requiring the business was the assets it contained.

61. Those assets were vehicles, plant for granulating copper, shears and a stripping machine.

62. In June 2013 HMRC required BMC to give security to the value of £510,850 or £304,550 if monthly rather than quarterly VAT Returns were submitted.

63. On 18 June 2013 HMRC received a letter from AST Green requesting that the frequency of the VAT Returns be changed from quarterly to monthly. The letter advised that the company was unable to raise the full value of the security bond and made an offer to pay £100,000.

64. HMRC responded on 26 June 2013 advising they were unable to accept BMC's offer of £100,000 as it would cover just one month of VAT liability and therefore not be reasonable or proportionate to the revenue at risk.

65. On 18 July 2013 AST Green wrote to HMRC stating that the main business activity of BMC would be changing from scrap metal to haulage and the turnover would therefore be lower. They anticipated turnover in the region of £360,000 per year and requested that the security bond be recalculated to taking this into consideration.

66. On 12 August 2013 Mrs Martin visited BMC accompanied by another HMRC officer. They spoke to Chris Cooper and another employee of BMC who had also worked at Towmasters. Chris Cooper confirmed that the main business activity at BMC was the processing of ferrous and non-ferrous metals and no other activities were undertaken by BMC.

67. When asked if there was any reason in the increase in output declared from £1.1 million in the VAT period 02/13 to £4.8 million in the VAT period 05/13 Mr Cooper said that maybe BMC had bought more stock.

68. When asked if it could be related to the downturn in trade for Towmasters and whether BMC has taken over from Towmasters Mr Cooper said no.

69. Later in the meeting when Mr Cooper had left the room the other employee stated that BMC had 'taken on Towmasters' mantel'.

70. No mention was made at the time of the visit of the purported change in trade to haulage.

71. On 16 August 2013 HMRC wrote to BMC regarding the purported change of main business activity. The letter stated the fact that during Mrs Martin's visit it was apparent that the business is still trading in scrap metal. The letter requested payment of the security bond within 14 days.

72. On 28 August 2013 HMRC received a letter from AST Green stating it was Mr Cooper's intention to stop trading in scrap metal from 30 August 2013 and deal solely as a haulage contractor.

73. By notice of appeal dated 16 September 2013 BMC appealed against the directions to lodge security.

74. HMRC proposed a visit to the businesses on 11 November 2013 to discuss BMC's current trading activities. On 7 November 2013 HMRC received an email from an employee requesting that the meeting on 11 November 2013 be postponed due to Chris Cooper attending a bail hearing and a trial for 3 days.

75. The letter stated that the company was closing down at the end of the month.

76. The meeting was rearranged to 26th November 2013. When this subsequently went ahead Mrs Martin noticed that there was a plastic sign up against the wall which stated 'sorry we are closed'. Chris Cooper told her that he had handed in notice on the yard but the general public was still coming and weighing in metal. Mr Cooper had been asked to perform a deal tracing exercise but told HMRC that the police had seized BMC's records and his computer.

77. Mr Cooper further advised that a Mr Short from HMRC had uplifted all the business records but when asked about the receipt HMRC would normally issue in such circumstances Mr Cooper advised he had not been provided with one.

78. Mrs Martin was unable to find any evidence that any officer with the surname Short or similar had ongoing enquiries into BMC.

79. BMC failed to submit a VAT return for the 11/13 period and an assessment was raised. On 14 January 2014 Mrs Franklin undertook an unannounced visit to BMC business premises to establish whether BMC was still trading from the premises. Chris Cooper advised that BMC was still trading but to a lesser extent and that the contract with the landlord was in force until March and BMC was planning to vacate the premises at the end of January.

80. When asked about the missing returns for the 08/13 and 11/13 periods Mr Cooper advised that his accountant Mike Howley was sent to prison for 3 years the previous week and he was struggling to get the returns completed. Mr Cooper advised he was subject to ongoing investigations by the police and HMRC. He said that it was unlikely BMC or WM Darleys would continue to trade.

Trading between RHJ and companies connected with the Cooper family

81. The Appellant traded briefly with Coombehill in December 2005 and January 2006. The total value of purchases was £10,000. The Appellant traded with Fellowbrook between December 2006 and August 2008. The total value of the trading in that period was £37,000. During that period HMRC issued a letter to RHJ forbidding them entering into a self-billing arrangement with Fellowbrook.

82. The Appellant did not trade with Brecks Holdings Ltd.

83. The Appellant traded with Towmasters from February 2010 until April 2013. In April 2013 The Appellant started to trade with BMC, and stopped trading with Towmasters, as they had been told by Chris Cooper he was merging the two companies and would use BMC in the future.

84. The Appellant undertook checks on WM Darleys in November 2013 and started trading with WM Darleys in January 2014.

HMRC decision around fraudulent default

85. Mrs Martin confirmed that she did not take a decision that BMC was a fraudulent defaulter.

86. Mrs Martin confirmed that the process around investigating BMC was constantly evolving and was based on the clear suspicion, due to the nature of the trade and the previous defaults of other Cooper companies, that it was likely that there would be another default.

Evidence from Mr Thomson - GPSE

87. The Tribunal heard from Mr Mark Thompson of HMRC in relation to GPSE. Mr Thompson produced a witness statement and also gave oral evidence. Mr Thomson was an honest but defensive witness.

88. GPSE was, at the relevant time, supplier to CCL, who was a supplier to Ronald Hull Junior Limited. In relation to the supplies from GPSE to CCL the Tribunal needed to decide firstly, was GPSE a fraudulent defaulting trader. If it was, could a link be proved between the

supplies made from GPSE to CCL. The director of GPSE at the relevant time was Mr Neil Gould.

89. GPSE had come to the attention of HMRC because CCL had performed a Wigan check. Mr Thompson explained that as CCL were on the 'MTIC radar' of HMRC, this would put companies that they traded with on the radar as well. On 20th of February 2013 HMRC carried out an unannounced visit to GPSE Ltd. The address given turned out to be GPSE's accountants and it was established that the new trading address was Unit D 16 of a business park in Kent. HMRC left a 7-day deregistration letter with the accountant due to the fact that CCL's trading address was different to the principal place of business which HMRC had recorded on their system. HMRC received a phone call from Mr Gould and arranged a meeting for 25 February at the business park. This meeting went ahead and GPSE were informed that one of their customers had carried out a validation check at Wigan which had brought GPSE to the attention of HMRC.

90. HMRC records show that HMRC discussed MTIC fraud with Mr Gould and the fact that this was now prevalent in the scrap metal industry. Mr Gould was provided with public notice 726 and the notice 'How to spot MTIC fraud'.

91. On 17 June 2013 HMRC carried out an unannounced visit to GPSE and found their business premises unoccupied. HMRC immediately deregistered GPSE on the grounds that the business could not be found and it was therefore not possible to confirm taxable supplies were still being made.

92. GPSE was deregistered for VAT on the 18 June 2013 and a letter was sent advising of this dated 19 June 2013. On 20 June Mr Gould contacted HMRC to advise that the company has moved premises from unit D 16 in the business park to unit D12. The reason given was that the business was making quite a lot of noise and they had asked they had been asked to move premises. On 24 June an unannounced visit was made to GPSE to establish the business activities and to consider the reinstatement of the VAT registration number. HMRC found the business at the new business premises and a meeting was held there are there. The business was again issued with public notice 726.

93. GPSE's VAT registration number was not reinstated due to the fact that Mr Thompson considered that a number of the features of the business gave him cause for concern.

94. One of these features was that GPSE's suppliers would often transport goods direct to GPSE's customers. Mr Thompson explained that this was a hallmark of MTIC fraud and that he had told Mr Gould that he was unwilling to reinstate GPSE's VAT number until he had had an opportunity to analyse some of the deal chains. Other features that Mr Thompson mentioned he was concerned about were that he believed the goods may not be insured, and that CCL's customers were paying CCL before CCL paid their supplier.

95. On 3 July HMRC received a letter from CCL's accountants requesting HMRC deal with them in relation to the reinstatement of the VAT number. The letter states 'Our clients have informed us that their VAT number was withdrawn. On 25 June 2013 you confirmed that their number would be reinstated. As yet the company has not received notification.'

96. Mr Thompson was unable to remember a conversation with GPSE about the re-instatement of their VAT number.

97. Mr Thompson confirmed that he had not made a decision that GPSE was a fraudulent defaulter.

98. Mr Thompson confirmed that when establishing the assessment made on GPSE he had not taken into account any credit for input tax that the business may have been due.

99. Mr Thompson was asked in relation to GPSE whether he knew that the continued deregistration of GPSE would result in the business becoming untenable, as HMRC were educating all businesses in the scrap metal industry to verify VAT numbers. Mr Thompson made the point that it may be possible to operate below the VAT threshold and therefore not need a VAT registration number but that he did agree that the loss of the VAT registration number would have an effect on the business but that his primary concern was to protect the revenue position.

100. After the deregistration there was communication with either Mr Gould or his accountants throughout the period from deregistration to 3 July 2013. From 3 July 2013 no communication was received from Mr Gould or his accountants.

Evidence from Mr McDonald – CCL

101. Mr McDonald produced 3 witness statements and appeared before the Tribunal to answer questions on his third witness statement only.

102. A significant amount of the evidence in Mr Macdonald's statements was not relevant to the points at issue in this hearing as it related to CCL's trade with a number of companies not in point here. It also related to other companies that the directors of CCL were associated with.

103. Relevant points from Mr McDonald's written evidence are as follows:

104. CCL was registered for VAT with VAT registration number 915 8894 75 with effect from 01 February 2007. It was required to file quartedy VAT returns for periods ending January, April, July and October each year.

105. CCL entered in a creditor's voluntary liquidation on 05 January 2015.

106. CCL verified GPSE's VAT number in February, March, April, May and June 2013.

107. Numerous meetings were held between CCL and HMRC to discuss MTIC fraud.

108. CCL conducted due diligence on GPSE but this did not include third party checks such as credit checks.

109. No written contracts were held between CCL and any trading partner.

110. Mr McDonald confirmed, in his third witness statement, that he had not spoken to Mr Hovers about the tax loss letter sent to RHJ Ltd about CCL.

Evidence from Mr Loureiro

111. The Tribunal heard from Mr Loureiro who adopted Mr McDonald's witness statements with minor corrections. Mr Louriero was able to answer general questions about the statements but had no first hand information about the events. Mr Louriero in addition gave evidence about the Mr Hovers of CCL entering into a directors disqualification.

112. Under cross examination Mr Loureiro agreed that some items in the disqualification were clearly not applicable to Mr Hovers.

Evidence from Mr Stephenson – Craig Cooper

113. The Tribunal had a witness statement from Mr Stephenson and heard oral evidence. Mr Stephenson was a straightforward witness. His evidence surrounded a visit made by Mr Stephenson to Towmasters in 2011. He had formed the opinion that Craig Cooper, in the absence of Chris Cooper, who was on holiday, was running the business.

114. Whilst the Tribunal is satisfied that Mr Stephenson held that opinion, we do not consider it adds anything to our understanding of the running of BMC in 2013, and certainly nothing in relation to the relationship between RHJ Ltd and BMC in 2013.

EVIDENCE ON BEHALF OF THE APPELLANT

115. We heard from Ms Karen Greasley, Group Financial Accountant of the Appellant. Mrs Greasley was responsible for all aspects of the financial accounting of the appellant including ledgers, payroll management, accounts and dealing with all correspondence and statutory forms associated with HMRC.

116. Mrs Greasley was a very competent and clear witness.

117. Mrs Greasley explained her understanding of MTIC fraud. Her understanding of such frauds was that at the time it was experienced in particular industries including the mobile telephone industry, and was, as the acronym suggests, missing trader intra community fraud. It was committed by criminals who exploit the way VAT is treated where the movement of goods between jurisdictions is VAT free. HMRC had advised the appellant that some of this fraud was taking in taking place in the scrap metal industry and sent the Appellant leaflets about how to how to try to spot such fraud.

118. Mrs Greasley explained they had never been given any literature on looking out for what HMRC referred to as phoenix companies. The subject of phoenix companies was never discussed at any meeting she attended with HMRC.

119. Mrs Greasley was aware that the appellant should look out for: unsolicited approaches from potential suppliers offering deals too good to be true, instructions to pay third parties (which in any case is illegal in the scrap metal industry), instructions to pay less than full price for the supplies (again Mrs Greasley explained this wouldn't happen as most of their suppliers of scrap operate on a self billing system whereby the appellant produces the invoice) and also to look out for newly established businesses with no trading history.

120. Mrs Greasley explained they generally dealt with suppliers who they knew and who had a history in the scrap metal business.

121. Mrs Greasley explained the due diligence carried out by the finance office when making a sale (i.e. due diligence on customers). This consisted of credit checking the customer using Experian and then asking a department manager involved in the potential sale for the likely value of the order and the customer details such as the invoice address, registered office and company registration number. The finance office would then produce a credit report based on the information provided. These were printed off and a decision was made based on the information contained within the report whether they should extend any credit until trading pattern can be established.

122. For prudency they always try to commence business with new customers on the basis of extending only limited credit which was then reviewed at regular intervals should trading continue.

123. Mrs Greasley did not see the need to run a credit report as part of the due diligence process for a supplier because there was no financial risk to the company. The Appellant is paying suppliers for a supply of materials which the appellant has physically received.

124. She explained that on several occasions they had asked HMRC to explain why they should be carrying out credit checks on potential suppliers. The typical response from HMRC to this would be that the Appellant should take direction from notice 726, carry out due diligence and then ‘they would not have any problems’. Mrs Greasley explained that notice 726 made a suggestion to do credit checks on suppliers but gave no guidance on what they should be looking for, and that was the question they constantly asked HMRC. They did not want the credit check to be a ‘box ticking exercise’. Even if a company recommended credit score was nil there was still no risk to the appellant as they were paying companies for materials not extending credit to them.

125. Mrs Greasley was very firm in saying that Mr Payne was incorrect to say that she had ever told him they did credit checks on suppliers. She believed he misconstrued a conversation where she was asked a general question about whether they did credit checks to which the answer was 'yes' because they did them on customers. She was very firm that she was not asked and did not say that they ever did credit checks on suppliers.

126. Mrs Greasley explained that if they were notified by HMRC of VAT cancellations they were acted upon immediately and they also acted on tax loss notifications. An example of this was a letter received from HMRC dated 11 of July 2012 about Premier Waste and Recycling Ltd and tax losses. The appellants stopped dealing with this company immediately.

127. Mrs Greasley explained in her oral evidence that they had not found HMRC very helpful previously when they had asked for guidance. Mrs Greasley explained that therefore when they received a tax letter about CCL they decided not to contact HMRC about this as when they had contacted HMRC in the past they have not been helpful. They made the decision to deal with this internally and Terry Hartley spoke to the CCL directors about this. As explained in Mr Hartley's evidence he was told by CCL that this was a mistake. Mr Hartley felt that it was plausible that such a letter could be written in error as they had previously received a VAT cancellation notice for a supplier and one day later a notice saying that the VAT number had been reinstated.

128. Mrs Greasley explained that on receiving the second loss letter they did decide to phone HMRC as two tax loss letters were obviously more serious than one.

129. Mrs Greasley confirmed that she never had any dealings with Craig Cooper or any knowledge of his disqualification.

130. We heard from Mr Terry Hartley, who at the time of the transactions was in charge of the non-ferrous metal division of the Appellant. Mr Hartley was a very clear and competent witness.

131. Mr Hartley had worked in the scrap metal industry for around 40 years at the time of the transactions in question. He explained that deals happened in various ways. The supplier could contact them by email, text or personally. The supplier would offer various materials which they would quote for. Whether they were successful in purchasing the material depended on the competiveness of the quote. Mr Hartley explained all the purchasing is spot business, in that there is no contract at that point, but with the supplier having an agreed time to deliver in should they wish to accept the quoted price.

132. Suppliers, including BMC and CCL, would contact him by phone regularly to obtain prices for various grades of material.

133. Sometimes he would visit the supplier to inspect the load before it was delivered. This might be because what they had was not quite the specification for a particular grade, so he would go down and have a look. If the grade was not quite right he would negotiate on the price.

134. Upon arrival at the Appellant, if the goods were not as described by the supplier, he would either reject the material or re-negotiate the price. In many instances this involved the segregation of the material in order to discuss and agree the value of the goods delivered. Mr Hartley explained this was standard practice in the recycling industry and the Appellant sometimes went through the same process on dispatched material to customers,

135. When material arrived into the yard, non-ferrous weighbridge tickets and the internal non-controlled ticket were not retained as they were not controlled documents. The non-ferrous department usually, but not always, weighed the incoming material on a 60 ton weighbridge, however the loads usually contained multiple grades which were weighed on smaller 4 ton

platform scales. All the information about the load received was transferred to an internal white ticket document with the individual weights recorded on it. This document was then sent to the cash office where the ticket calculations were checked and transferred to the official controlled purchase document

136. Mr Hartley explained this had been the procedure for some 23 years and had never been an issue with previous HMRC inspections. The document which was issued to the customer was an official document which conformed to the Scrap Metal Dealers Act and as such is the official document presented to government bodies when required.

137. In relation to MTIC fraud, Mr Hartley said they were told by HMRC that people were coming out of MTIC fraud in mobile phones and starting to deal in scrap metals. He understood HMRC to say that they should look out for people that had been involved in mobile who had become involved in scrap metals.

138. Mr Hartley was clear they were not told to look for what HMRC refer to as phoenix companies or to associate it with VAT fraud. It was never mentioned.

139. Mr Hartley explained it was decided that the Appellant would only deal with people that they knew and who had a history in the trade. Chris Cooper had been in the metals trade for decades and they had been dea1ing with him for a number of years. He clearly was not someone who had recently moved into the metals trade in order to commit MTIC fraud or was likely to go 'missing' – i.e. the type of person HMRC had told them to aware of.

140. They had been dealing with CCL since 2008, and had built up a good trading relationship with them over the years.

141. Mr Hartley had visited the premises of both BMC and CCL and concluded they had substantial premises.

142. RHJ Ltd also checked on the Rotherham Borough Council Register to see if BMC were registered with the Scrap Metal Dealers Act 2013 and found that they were. BMC also had a waste carrier licence and an environment agency registration.

143. Mr Hartley explained that they did get many offers that were 'too good to be true' and they turned them down. For example, during the period after HMRC had alerted them to MTIC fraud, a trader of this type contacted them offering 100 ton loads of copper cathode at very cheap price. Mr Hartley looked up the trader's details and he was apparently trading from premises above a delicatessen shop in London. Mr Hartley then gave Mr Payne at HMRC all of the details of this trader, stating that we had been approached in this manner. Mr Hartley had no follow up from Mr Payne, nor any further instruction as to what he would like him to do further other than to refuse the business offered if they thought it was dubious.

144. Mr Hartley explained that HMRC had not given them any guidance about tax loss letters. When they asked HMRC what to do, Mr Payne said that was their decision. Accordingly, they generally ceased dealing with businesses if the business was a named supplier on the tax loss letter.

145. The exception to this was CCL. In this case Mr Hartley phoned Mr Hovers at CCL. Mr Hovers told Mr Hartley he would speak to Wes Macdonald at HMRC. In a short space of time Mr Hovers phoned back Mr Hartley and told him that he had spoken to Mr Macdonald at HMRC and the letter was issued in error.

146. It is common ground that this was not true, that Mr Hovers never in fact spoke to Mr Macdonald. However, at the time Mr Hartley believed it to be true, and had experience of HMRC issuing a deregistration latter to a supplier and then re-registering the supplier immediately.

147. RHJ Ltd therefore decided that they would continue to deal with CCL.

148. When the second tax loss letter naming CCL arrived they ceased dealing with them immediately.

149. Mr Hartley explained the due diligence procedures that RHJ Ltd undertook.

150. They received a letter on 29 April 2009 about how we should verify the VAT status of customers and suppliers. Based on that letter, they asked new and potential suppliers and customers to provide:

(1) VAT certificate

(2) Letter of introduction, including directors name and signature

(3) Certificate of incorporation.

(4) Name of supplier/Customer.

(5) Contact details, such as telephone numbers, fax numbers, email addresses and mobile numbers.

(6) Details of directors and/or responsible members. Bank sort code and account number.

151. Mr Hartley explained that he satisfied that CCL and BMC were legitimate businesses, trading, from substantial premises, genuinely engaged in tne trade. They had the knowledge and resources to carry out the deals they were offering to us and there was nothing suspicious about the price or other features of the transactions that led him to doubt the legitimacy of the deals.

152. Mr Hartley stated that before Barnsley Metal Company, they had traded with Chris Cooper for a number of years through Towmaster Metals Ltd without incident. Chris Cooper told him that he had bought BMC and intended to merge the two companies together. Mr Hartley thought nothing of this when he switched trading to BMC.

153. Mr Hartley also explained that he knew HMRC were also visiting BMC abd would have been aware of the two businesses and the merger.

154. We heard from Mr Ronald Hull, Managing Director of the Appellant. We found Mr Hull to be a truthful witness, however under cross examination he appeared at times confused. We place little weight on his evidence under cross examination and where it appears to differ from that of Mr Hartley and Ms Greasley we prefer their evidence.

155. Mr Hull started the business over 40 years ago and it has grown to an impressive size. It employs over 200 people and Mr Hull has a senior management team to help him run the business.

156. Mr Hull is proud of the business, its environmental standards, and the very good relationships the business has with HMRC and all other government bodies including the police and the local environmental standards.

157. Mr Hull gave examples of the initiatives in which Ronald Hull Junior Ltd ‘led the way’ for example:

(1) They implemented cheque payments for VAT to improve traceability

(2) They introduced, long before the legal requirement, a policy of requesting photo ID from traders

(3) They had a policy of not buying from people ‘on foot’ in order to combat petty theft in the local area.

158. Mr Hull has long been an advocate of reverse charge in the scrap metal industry and has taken this matter up with his local MP.

159. Mr Hull explained there would be no benefit to the business being involved in fraud but there would be a considerable risk to his reputation, and to the business and hence all of the staff he employs, which he cares very much about.

160. Mr Hull was asked about his relationship with Chris Cooper and his family. Mr Hull maintained that although he knew of Mr Cooper and that he was a scrap metal dealer, he did not have a relationship with him. He did not hear anything about him that would lead him to be concerned that he was not a reputable dealer. He had not met Craig Cooper and never heard about his disqualification.

161. The remainder of Mr Hull's evidence concerned due diligence matters. This did not add anything to that already stated by Mr Hartley and Ms Greasley. There was some confusion, under cross examination, as to whether it was RHJ Ltd policy to undertake credit checks on suppliers. We prefer the evidence of Ms Greasley in this regard.

THE LAW – RIGHT TO DEDUCT

162. The law is discussed in greater detail under 'Knew or should have known' below, but can be very briefly stated here. The Court of Appeal in *Mobilx (Mobilx Ltd (in administration) v The Commissioners for HMRC* [2010] EWCA Civ 517, [2010] STC1436.) states:

> 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).
>
> The right to deduct input tax is integral to the system of VAT. It may not "in principle" be limited (§ 53). It is integral to the system because it ensures the principle of fiscal neutrality which lies at the heart of the system of VAT.
>
> It is necessary to recall the importance of that principle since it explains why the jurisprudence of the ECJ has been so resistant to attempts to combat fraud by encroaching upon the right to deduct in the case of traders who are not themselves participants in the fraud. VAT is a tax on consumption applying to goods and services up to and including the retail stage. It is proportional to the price charged by the taxable person in return for the goods or services he has supplied. It is charged at each stage of production or distribution. At each stage the amount of tax which the goods or services have already borne is deducted from the tax, for which the taxable person is liable. Deduction has two crucial effects: the tax is levied at any given stage only on the value which is added at that stage; secondly, the taxable person does not bear the burden of the tax, the final burden is on the consumer (see Art. 2 of the First Directive 67/227/EEC and Case C-475/03 *Banco Popolare di Cremona* [2006] ECR I/9373 at §§ 21 and 22).
>
> Since the right to deduct is fundamental to the system of VAT because it ensures that the charge is limited to the value added at each stage of the supply and because it ensures fiscal neutrality, it may not, in principle, be limited; any derogation from the principle of the right to deduct tax must be interpreted strictly (see Case C-414/07 *Magoora* [2008] ECR I-000). Moreover, the right must be exercisable immediately in respect of all taxes charged on input

> transactions. 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.....

163. The ECJ in *Kittel* (*Axel Kittel v Belgium; Belgium v Recolta Recycling* (C-439/04 and C-440/04) [2006] ECR 1-6161) sets out that the right to deduct must be refused:

> "… 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'." (*Kittel* at [59]).

164. Any denial of VAT input tax therefore requires

(1) A tax loss

(2) That tax loss to be as a result of fraudulent evasion of VAT

(3) A connection between the fraudulent eveasion of VAT and the transactions on which input tax is denied

(4) Where there is such a connection, a situation where the trader knoew or should have known that its transactions were connected with the fraudulent evasion of VAT.

It is accepted that there was a tax loss in all deals and therefore it is not necessaru for us to consider that issue further.

165. We therefore have to consider:

166. In relation to GPSE, was it a fraudulent defaulting trader?

167. In relation to RHJ Ltd's trade with CCL, was there a connection to CCL's trade with GPSE?

168. In relation to CCL, did RHJ Ltd know, or should they have known, that the transactions RHJ Ltd entered into were connected to fraud?

169. In relation to BMC, was it a fraudulent defaulting trader?

170. In relation to BMC, did RHJ Ltd know, or should they have known, that the transactions RHJ Ltd entered into were connected to fraud?

FRAUDULENT EVASION – GPSE

171. It is HMRC's case that GPSE was a fraudulent defaulter. GPSE did not submit a tax return for its final period of trading, and has not paid over VAT due to HMRC which HMRC estimate to be over £600,000.

172. Mr Thomson, in his witness statement, says 'GPSE was identified as a potential new MTIC trader due to the fact that CCL had requested the clearance of this company through HMRC's Wigan validation unit.'.

173. It is clear that once HMRC believes one company is involved in VAT fraud the (entirely proper) verification by that company of any VAT registration of another company places that second company under suspicion.

174. HMRC have produced very little evidence that GPSE was a fraudulent defaulter. Their case is that they de-registered GPSE as it was not present at its principal place of business. When they were notified of the change of location, provided with a plausible reason why the change of location occurred, and subsequently verified this location with a site visit, they did not re-register GPSE. Their reason for not re-registering was that there were other suspicious indicators such as suppliers were directly transporting goods to customers.

175. However the direct result of the removal of the VAT registration was that GPSE's scrap metal business became extremely difficult to operate, as no reputable business in the industry would deal with a dealer who was not registered for VAT, as HMRC were telling all businesses in the industry to check VAT registrations.

176. HMRC's case is that the failure to pay the final VAT due is as the result of fraud. Their case refers to a number of other companies who traded with GPSE and who may be fraudulent, but for the purposes of this case, we require evidence that GPSE was a fraudulent defaulter.

177. Mr Thomson of HMRC confirmed he did not make a decision that GPSE was a fraudulent defaulter.

178. That is of course not necessary in order for HMRC to prove to this Tribunal that GPSE was a fraudulent defaulter. However we have not seen any evidence that would point to fraud in this case, when weighed up against the other possibility for default which is that the business failed due to the removal of the VAT registration.

CONNECTION – GPSE

179. We turn now to the case of connection with fraud. Having decided that HMRC have not established to our satisfaction that GPSE was a fraudulent defaulter, we do not need to go on to consider the question of connection. However, on the assumption that there may be a fraudulent default somewhere before GPSE we go on to consider whether there is a connection between trades between GPSE Limited and CCL and onward sales from CCL to RHJ Ltd.

180. As there were only 6 deals in question we can look at each one of these in turn.

181. Before looking at the specifics of the disallowed deals, HMRC first took us to a set of deals between CCL and each of GPSE Ltd and RHJ Ltd in the earlier quarter.

182. We were shown 3 deals in this quarter.

183. The first was a sale from GPSE Ltd to CCL with an invoice date from GPSE of 14 February 2013. The goods were 28.340 tonnes of copper granules and a total cost excluding VAT of £134,898.40.

184. CCL sold 28.357 tonnes of copper granules to RHJ Ltd with an invoice date of 11 February 2013.

185. The second deal is an invoice from GPSE to CCL on 19 February 2013. This invoice is for 3 items: 28.6 tonnes of tinned copper electrode, 290 kg of 98% heavy copper and 104kg of mixed brass. The invoice total is £132,029.66.

186. There is a corresponding invoice from CCL to RHJ Ltd on the 15 February 2013 for 104 kg of mixed brass, 28.602 tonnes of tinned copper electrode and 289 kg of 98% heavy copper.

187. The third deal was related to an invoice from GPSE dated 28 February 2013 for 29.230 tonnes of dry bright and 50 kg of 98% heavy copper. There was then an invoice from CCL to

RHJ on the 1 March 2013 for 29.23 tonnes of dry bright copper wire and 50 kg of 98% heavy copper.

188. HMRC did not deny input tax in relation to any of the purchases from CCL in the 04/13 quarter due to the fact that the time limit to do so had expired.

189. We then turn to the deals in question where HMRC did deny the input tax to RHJ on its purchases from CCL.

190. The first invoice for the 07/13 period relates to a sale by CCL to RHJ of 12690 kg of 98% heavy copper on the 29 July 2013.

191. HMRC trace this to an invoice from GPSE to CCL dated 10 June 2013 again for 98% heavy copper for exactly the same quantity, 12,690 kg.

192. The second deal is a sale from CCL to RHJ on the 1 August 2013 for 23.498 tonnes of 98%. HMRC trace this to a GPSE the invoice to CCL labelled heavy scrap copper in a quantity of 23.4 tonnes on the 18 June 2013.

193. The third deal is an invoice from CCL to RHJ on 5 August 2013. There are two metals on this invoice, but HMRC trace the only one, 25,925 kgs of mixed copper granules which HMRC trace back to an invoice from GPSE to CCL on the 13 June 2013 labelled 98% copper granules with a weight of 25,926 kg.

194. The fourth deal is an invoice from CCL to RHJ on 15 August 2013 for 19,907kg copper granules. HMRC trace this to an invoice from GPSE to CCL for 19,907kg of 98% copper on the 24 of May 2013.

195. Deals 5 and 6 deals actually related to the same invoice from CCL to RHJ for two quantities of 98% heavy copper 3500kg and 4868 kg on an invoice dated 21st of August 2013 which HMRC traces to a GPSE invoice to CCL on the 31 May 2013 for two quantities of 98% copper, again of weights 3500kg and 4868 kg.

196. These deals are summarised in the table below:

Date sold	Date bought	Weight sold (kg)	Weight bought (kg)	Difference time (days)	Difference weight (kg)
29/7/13	10/6/13	12690	12690	49	0
1/8/13	18/6/13	23,498	23,400	44	98
5/8/13	13/6/13	25,926	25,925	53	1
15/8/13	24/5/13	19,907	19,907	83	0
21/8/13	31/5/13	3,500	3,500	82	0
21/8/13	31/5/13	4,868	4,868	82	0

197. This table shows that we are faced with two opposing probabilities. It is likely that, where items of the same weight (or same within a tolerance of less than 1%) are bought and sold, that the item sold is the same as the item bought. Where the weights are round numbers that is possibly less likely, but here we mainly have weights not in round 100s.

198. However, it is unlikely that a scrap metal dealer would leave metal in his possession for periods as long as 11 weeks without selling it on.

199. It is particularly unlikely that a metal bought in May should be traced to a sale in August when sales of the same metal had been made in July and earlier in August.

200. We also note the contrast between the transactions in the earlier quarter, where it appears that transactions buying and selling metal were made within a few days of each other, and here where the transactions are alleged to have taken place weeks apart but still be connected.

201. We consider that the length of time outweighs the similarity in weights, and we conclude that connection has not been proved.

FRAUDULENT EVASION – BMC

202. It is HMRC's case that BMC was a fraudulent defaulting trader. Under cross examination of the relevant witnesses it was unclear when HMRC decided that BMC was a fraudulent defaulting trader or who had made that decision, but that is not relevant to the decision this Tribunal has to make. The decision this Tribunal has to make is whether on the evidence presented to the Tribunal BMC was a fraudulent defaulter.

203. It is common ground that BMC complied with all their VAT obligations up to 05/13.

204. The return for the next period was due on 7/10/13. They were not therefore in default until 8/10/13, which is roughly halfway through the period that covers the transactions in question. HMRC therefore need to show that there was an intention to default.

205. BMC entered insolvency on 30 June 2014 owing VAT of £2.6m. It is HMRC's case that this was a fraudulent default, essentially pre-planned by the director of BMC.

206. HMRC rely on a number of facts to make their case.

207. Firstly, they rely on the fact that Chris Cooper and his son Craig Cooper (who HMRC allege was heavily involved in the running of BMC) had a pattern established over many years of running a business which goes into liquidation owing VAT.

208. HMRC point to the fact that (subsequent to the transactions in question here) Chris Cooper was disqualified from being a director and was imprisoned for 12 months as a result of his conduct as a director of Towmasters.

209. HMRC believe that in relation to the trade of Towmasters, BMC and WM Darleys, a clear pattern is shown, amounting to planning, that a new business will take over from the old business and the old business will fold, leaving a VAT debt.

210. HMRC state that during his dealings with them in relation to BMC, Chris Cooper did not act honestly, telling them he was planning to move into the haulage business when this did not prove to be the case.

211. The Appellant's case is that the alternative reason for the failure of BMC to file a VAT return is that their records were not available, having been taken by the police.

212. The Appellant points out that at the time, with full information available to them on previous defaults by companies run by the Cooper family, HMRC did not make the decision that BMC were a fraudulent defaulter.

213. The Appellant submits that as Mr Cooper was under criminal investigation at the time, this makes it unlikely that he would make things worse for himself.

214. We decide that HMRC has made out the case that BMC was a fraudulent defaulter and that the intent to defraud was present throughout the relevant period.

215. We consider that the multiple occasions that Chris Cooper's companies have defaulted on VAT make it likely that this was one of the same pattern. We consider there is clear evidence of dishonesty in his dealings with HMRC, in that his accountants sent a letter to HMRC on 18 July 2013 saying BMC was going to move into haulage only. In a visit made by

Emma Raglan (now Martin) on 12 August 2013 Mr Cooper had long conversations with her about the scrap metal business and did not mentioned haulage at any point.

216. Even if records had been taken by the police, we consider that BMC did not make any effort to engage constructively with HMRC to file their return and pay the tax. We conclude that there was an intent to enter into a fraudulent default.

217. We do not consider Mr Cooper being under a criminal investigation makes it any more or less likely that he would, at that specific point in time, seek to default on VAT.

KNEW OR SHOULD HAVE KNOWN – THE LAW

218. HMRC need to prove that 'the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with the fraudulent evasion of VAT' (Kittel at [59]).

219. Having dealt above with 'connected' and 'fraudulent evasion' we now turn to 'knew or should have known'.

220. It is convenient to set out the law that we are applying here before we turn to the facts of the case.

221. The case of Synectiv Limited [2018] FTT 0092 (TC) contains a useful summary of the law and we quote the relevant parts below:

> The key applicable legal principles are derived from *Axel Kittel v Belgium; Belgium v Recolta Recycling* (C-439/04 and C-440/04) [2006] ECR 1-6161 and the Court of Appeal decision in *Mobilx Ltd (in administration) v The Commissioners for HMRC* [2010] EWCA Civ 517, [2010] STC1436. There is no relevant distinction between domestic and Community law in this regard (*Mobilx* at [49]). The right to deduct must be refused:
>
> > "… 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'." (*Kittel* at [59]).
>
> The only issue in dispute here is whether Synectiv "should have known" that it was participating in a transaction connected with fraudulent evasion of VAT. The meaning of this phrase has been considered in a number of cases, including by the Court of Appeal in *Mobilx* and more recently in *Davies & Dann Ltd v HMRC* [2016] EWCA Civ 142, [2016] STC 1236. In *Mobilx*, Moses LJ explained at [51] that the concept could be understood by reference to the earlier ECJ decision in *Optigen Ltd v HMRC* (C-354/03) [2006] STC 419, which referred to the absence of "means of knowledge", and that the ECJ must have intended the phrase "knew or should have known" to have the same meaning as "knowing or having any means of knowing". He went on to say the following:
>
> > "[52] If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for 30 negligence, but because the objective criteria for the scope of that right are not met…A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

21. It is accepted, however, that this is a high hurdle. The burden of proof is on HMRC (to the balance of probabilities). It is not enough to demonstrate that the trader should have known that he was running a risk that the transaction might be connected with fraud, or even that it was more likely than not that it was so connected: it must be shown that he should have known that he was taking part in such a transaction. Only that approach is consistent with the principle of legal certainty, under which a trader should be in a position to know before he enters into a transaction, and by reference to objective criteria, whether he will be entitled to deduct the VAT (paragraphs [55] to [58] in *Mobilx*). Moses LJ went on to explain the position as follows:

> "[59] The test in Kittel is simple and should not be over-refined. It embraces not only those who know of the connection but those who "should have known". Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in Kittel.
>
> [60] The true principle to be derived from Kittel does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion."

22. Towards the end of the judgment Moses LJ also provides some guidance to tribunals. Paragraph [82] contains a warning not to focus unduly on the question of whether the trader has acted with due diligence, because that may deflect the tribunal from the essential question of whether the trader "should have known". Paragraph [84] approves comments of Christopher Clarke J in Red 12 Trading Ltd v HMRC [2010] STC 589 at [109] to [111] about the importance of considering individual transactions in their context, including drawing inferences from a pattern of transactions, and stating that the tribunal is entitled to look at "the totality of the deals effected by the taxpayer (and their characteristics), and at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances in respect of all of them". Moses LJ also referred to questions the tribunal had asked in that case, which he said were important questions which may often need to be asked. Those questions, set out at paragraph [72], included:

(1) why a company with comparatively little history of dealing mobile phones was approached with offers to buy and sell very substantial quantities;

(2) how likely it was in ordinary commercial circumstances that a company in the trader's position will be requested to supply large quantities of particular types of phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity;

(3) whether the supplier was already making supplies direct to other EC countries (in which case the trader could have asked why the supplier was not making supplies direct);

(4) why the trader was being encouraged to become involved in these transactions, and what benefit might those doing so derive when they could instead take the profit for themselves.

To these features could be added features referred to by Christopher Clarke J, including whether there are a number of transactions with identical percentage mark ups, made by a trader with virtually no capital as part of a huge turnover with no leftover stock, and mirrored by numerous other chains in which the taxpayer has participated and in each of which there has been a defaulting trader.

23. Moses LJ then stated at [84] that such circumstantial knowledge "will often indicate that a trader has chosen to ignore the obvious explanation as to why he was presented with the opportunity to reap a large and predictable reward over a short space of time".

24. Davis & Dann related to a "grey market" trader in consumer goods who conducted a very large back to back deal in razor blades following unsolicited approaches made in quick succession by a supplier (with whom it had not previously dealt) and a Spanish customer, despite a specific warning from HMRC about razor blade deals. The facts were clearly extreme, including that the supplier was a wholesaler in drinks and that the goods were shipped to an entity in Calais whose business was the wholesale of wood, construction materials and sanitary equipment. The supplier was known not to be an authorised distributor, whereas the trader had previously only bought from authorised distributors. The sole issue was whether the trader should have known that the transactions were connected with the fraudulent evasion of VAT. The FTT dismissed the appeal on the basis that the only reasonable explanation was a connection with fraud. The taxpayer's appeal was allowed by the Upper Tribunal but the FTT decision was reinstated by the Court of Appeal, with Arden LJ giving the only judgment. It is worth noting that it was common ground that what HMRC needed to show was that the only reasonable explanation for the transactions was that they were connected to a VAT fraud: paragraph [4].

25. Arden LJ's judgment makes it clear that the tribunal must guard against over compartmentalisation of the factors, rather than the consideration of the totality of the evidence. This was the error into which the Upper Tribunal had fallen. In particular, there may be an explanation for an individual factor which means that knowledge does not meet the required standard. That factor then ceases to be probative but it is still relevant (paragraph [60]). The requirement to consider the evidence as a whole has been repeated in the more recent Court of Appeal decision in *CCA Distribution Ltd v HMRC* [2017] EWCA Civ 1899 at [30], [31] and [46], where the importance of standing back and looking at all the circumstances was again emphasised. It is not the correct approach to consider individual pieces of evidence and determine whether each piece proves that the taxpayer "knew or should have known" on the balance of probabilities. That test must be applied to the totality of the evidence (paragraph [37]).

26. As already mentioned, Davis & Dann proceeded on the basis that the "should have known" test is equivalent to the "only reasonable explanation" formulation. However, there is Upper Tribunal authority, *AC Wholesale Limited v The Commissioners* [2017] UKUT 191 (TCC), confirming that this formulation is not an exhaustive description of the "should have known" test, but rather one way of showing that the test is satisfied. In addition, this case confirms that it is not necessary for HMRC devote time and resources to considering and identifying any other possible reasonable explanations and then putting forward evidence and argument to counter them even where the taxpayer has not sought to rely on such explanations (see in particular paragraphs [27] and [29]). Of course, any explanation actually put forward by the taxpayer should be considered, and the Upper Tribunal acknowledged

that if that occurs it "may be necessary" for HMRC to show that the only reasonable explanation was fraud (paragraph [30]).

27. It is also worth noting that in *Fonecomp v HMRC* [2015] EWCA Civ 39, [2015] STC 2254 Arden LJ also confirmed at [51] that the "should have known" test does not mean that the trader has to have the means of knowing how the fraud actually occurred, but simply that fraud has occurred or will occur at some point in a transaction to which its transaction is connected.

28. Mr Farrell, for Synectiv, also suggested that at the end of his judgment in 10 Mobilx Moses LJ effectively equated the "should have known" test with turning a "blind eye". Although this can clearly be used as a descriptor of some circumstances where the test is met by a trader who chooses to ignore clear indicators of fraud, Moses LJ was not restating the test in those terms. The reference was made at paragraph [85] in the context of comments made in HMRC's VAT Notice 726 which 15 used that phrase.

KNEW OR SHOULD HAVE KNOWN – THE EVIDENCE

222. HMRC submit that RHJ Ltd was well aware that 'MTIC fraud' was an issue in the scrap metal industry. On numerous occasions from 2008 onwards HMRC officers had visited RHJ Ltd, and had spoken to Ron Hull, Karen Greasely and Terry Hartley about MTIC fraud.

223. The company had been provided with Public Notice 726 on numerous occasions both through the post and handed over in person.

224. The company had received tax loss letters relating to a number of suppliers.

225. HMRC had discussed due diligence with the Appellant (Ron Hull, Karen Greaseley and Terry Hartley) on a number of occasions. HMRC had suggested on a number of occasions that in addition to credit checks on customers, RHJ Ltd should undertake checks on suppliers.

226. HMRC submit that the due diligence that RHJ Ltd performed on BMC and CCL was not sufficient. They further submit that had they performed sufficient due diligence, they would have come across information that would have led them to conclude that the suppliers must be fraudulent.

227. HMRC further submit that the Appellant would have known that Chris Cooper had a history of being a director of companies that folded, and also that Craig Cooper was disqualified from being a director.

228. The Appellant submits that the due diligence was sufficient, and that further due diligence would not have led to evidence of fraud being uncovered.

229. Furthermore, the Appellant submits that due diligence is only one part of the totality of the evidence, and that other factors, such as the history of dealing with BMC and CCL, must be taken into account.

230. The Appellant submits that none of the senior management of RHJ knew any of the Cooper family well, and knew nothing of Craig Cooper's disqualification or that earlier companies had failed owing large amounts of VAT.

Due Diligence and Notice 726

231. A large amount of the evidence about the sufficiency or otherwise of the due diligence, and the knowledge of VAT fraud in the scrap metal industry, revolves around Public Notice 726. We therefore set out a certain amount of detail about what notice 726 contains.

232. Notice 726 is titled 'Joint and several liability for unpaid VAT'.

233. It explains how buying or selling specified goods could lead to liability for the unpaid VAT of another registered business.

234. It is common ground that scrap metal is not one of the 'specified goods' but that HMRC gave out the notice to scrap metal dealers to provide them with assistance as to what due diligence they should be doing.

235. In the notice relevant at the time, section 2.3 states: 'These rules are designed to tackle VAT fraud. A virulent type of VAT fraud is known as Missing Trader Intra-Community (MTIC) VAT fraud. MTIC fraud is a systematic criminal attack on the VAT system detected in many EU member States. In its simplest form, the fraud involves a fraudster obtaining a VAT registration number in the UK for the purposes of purchasing goods free from VAT in another EU member State, selling them at a VAT inclusive purchase price in the UK and then not paying the output tax due to HMRC. The goods are then through a number of U.K businesses and finally sold outside the UK free from VAT. The final UK business claims a VAT repayment from HMRC that, if paid, crystallises the loss at the start of the UK supply chain.

This type of fraud relies heavily on the ability of fraudulent businesses to sell goods or services to other businesses that are complicit in the fraud, prepared to turn a blind eye, or not sufficiently circumspect their trading connections. Such action fuels the growth of the fraud. These rules remove the attraction of financial gain.

236. Section 6 of the notice is entitled 'Dealing with other businesses – How to ensure the integrity of your supply chain.

237. Section 6.2 includes 'The following are examples of specific checks carried out by businesses that took part in the exercise in 2003 when these rules were introduced. These may also help you to decide what checks you should carry out, but this list is not exhaustive and you should decide what checks you need to carry out before dealing with a supplier or customer:

- obtain copies of Certificates of Incorporation and VAT registration certificates
- verify VAT registration details with HMRC
- obtain signed letters of introduction on headed paper
- obtain some form of written and signed trade references .
- obtain credit checks or other background checks –from an independent third party
- insist on personal contact with a senior officer of the prospective supplier, making an initial visit to their premises whenever possible .
- obtain the prospective supplier's bank details, to check whether

  a) payments would be made to a third party; and

  (b) that in the case of an import, the supplier and their bank shared the same country of residence

238. It is common ground that large parts of the notice contain examples and details that are not relevant to the scrap metal industry.

239. We turn first to the points around due diligence. HMRC have not produced any evidence that due diligence performed on BMC and on CCL was materially different to that performed on other similar suppliers. It is (now) common ground that RHJ Ltd started requesting a formalised due diligence pack from its new suppliers after the point at which it had started trading with CCL, and before the point at which it started trading with BMC.

240. The due diligence performed on CCL was to obtain a copy of the CCL VAT certificate, details of the CCL bank details, and a self billing arrangement.

241. RHJ also state that they performed a check on the VAT registration with HMRC at the time they started trading with CCL, in 2008. Since 'Wigan checks' started on a central basis in 2009, HMRC have been unable to find a check done by RHJ Ltd on CCL, but we accept the truth of the statement from RHJ Ltd that one was performed.

242. HMRC state that RHJ should, in addition to this initial check, firstly update their checks on suppliers annually, and secondly also perform credit checks on suppliers.

243. A credit check on CCL would have shown a nil credit limit advised. HMRC say that this should have led RHJ Ltd to perform further due diligence. Examples of this due diligence they gave would be to ask CCL for the due diligence it performed on its own suppliers, and to be suspicious that CCL could run a business without credit.

244. The Appellant state that it would be extremely unusual commercial practice to enquire of its suppliers what due diligence they did on their own suppliers. The supplier would not release names of their suppliers as this may lead to loss of business.

245. The Appellant also state that they repeatedly asked HMRC what they should look for if they performed a credit check on a supplier. RHJ were not extending credit to their suppliers so even if a nil credit limit were advised they did not run a risk. In the scrap metal business it would not be necessary to be able to obtain credit, as if they sold goods on quickly, the payment from their customers can be used to pay their suppliers. RHJ state that HMRC were unable to help them in this regard.

246. In relation to the due diligence performed on BMC, the Appellant's due diligence records consist of:

(i) An undated standard form letter under the hand of Terry Hartley, asking for 7 specified documents *"In order to comply with HM Revenue and Customs"*.
(ii) Faxed copy of amended BMC VAT certificate, amended on 31 October 2012 and showing a fax date of 17 December 2012.
(iii) Signed letter of introduction from BMC under the hand of Chris Cooper, showing a fax date of 17 December 2012.
(iv) BMC certificate of incorporation, showing a fax date of 17 December 2012.
(v) Unsigned letter from BMC under the hand of Chris Cooper, showing a fax date of 17 December 2012, containing information relating to the company's control and ownership, address and bank details.
(vi) Completed form setting out BMC's name, address and bank details, showing a fax date of 17 December 2012.
(vii) Completed form setting out BMC's name, VAT number, phone and fax numbers, responsible person and bank details, showing a fax date of 17 December 2012.
(viii) RHJ fax under the hand of Terry Hartley, address to HMRC and dated 17 December 2012, requesting a VAT verification check on BMC.
(ix) HMRC fax cover sheet, dated 18 December 2012, attaching letter.
(x) HMRC faxed letter, dated 18 December 2012, confirming BMC's VAT number.
(xi) A self-billing agreement, signed by Terry Hartley and dated September 2013 (apparently faxed to the Appellant on 19 September 2013)

247. HMRC submit that in addition to this they would expect to see a credit check done on BMC. They also state that the appellant could have reviewed information available on Companies House in relation to former companies run by Chris and Craig Cooper. They state that had RHJ Ltd done so, they would have shown that HMRC was the primary creditor of each, with debts running into millions of pounds.

248. HMRC also state that RHJ should have performed due diligence that would have revealed that Craig Cooper was disqualified as a director and that this disqualification was related to VAT fraud.

249. HMRC also state that RHJ Ltd should have been suspicious of the Cooper family companies because HMRC had told RHJ Ltd not to enter into a self billing arrangement with Fellowbrook, a Cooper family company that BMC traded with in 2006-2008.

250. HMRC also state that RHJ should have been suspicious of BMC being able to trade with no credit limit.

251. HMRC point to the fact that the Cooper family have run a series of businesses that have failed and owe large amounts of VAT, and that RHJ Ltd should have been suspicious of the fact that companies were taking over business from a previous (Cooper family) company.

252. The HMRC opening submission states that the due diligence was perfunctory and 'cannot have given the Appellant any serious comfort – it has all the appearance of window dressing or a box ticking exercise'.

253. The Appellant's position is that they thought they were doing the due diligence that HMRC required, and that HMRC (Mr Payne) had himself told them that their due diligence was good.

254. The Appellant did not see what comfort it would gain from a credit check on a supplier to whom it was not extending credit, and despite asking HMRC what they should do with this information they were not told.

255. The Appellant questions whether at the time (various points between 2008 and 2013), information now publically and relatively easily available on the Companies House website would have been easy to find. In particular they challenge the point that they could have found out that previous Cooper family companies had folded owing large debts to HMRC.

256. The Appellant state that they did further due diligence on BMC such as checking that BMC were registered with Rotherham Borough Council under the Scrap Metal Dealers Act, and also visiting their premises.

257. The Appellant points out that BMC was run by someone that had been in the scrap metal trade for decades and they had no reason to think suspiciously of the transactions they were doing.

Tax Loss letters

258. RHJ Ltd received a tax loss letter in relation to CCL dated 9 August 2013. RHJ Ltd received a second tax loss letter in relation to CCL dated 7 November 2013. RHJ Ltd traded with CCL until 14 November 2013. HMRC submit that the fact that RHJ Ltd did not immediately cease to trade with CCL Ltd shows that they did not take indicators of VAT fraud seriously, and that shows that they should have known that CCL was involved in VAT fraud.

259. The Appellant stated that in every other case apart from CCL, RHJ Ltd stopped dealing with any supplier about whom they received a tax loss letter. They point to the cases of Premier Waste and Recycling Ltd (letter received in 2012) and Cox Recycling Ltd (letter received 2 August 2013.

260. Ms Greaseley explained that they were not very clear what to do when they received a tax loss letter as HMRC always made it clear that the decision was up to them. She explained that when the first letter about CCL was received RHJ Ltd decided to 'deal with it themselves' as they had previously not found HMRC helpful.

261. This assertion is backed up by the fact that Ms Greaseley had in fact phoned HMRC on 5 August 2013 about the letter received in relation to Cox Recycling Ltd a few days earlier. On receiving the letter about CCL Ltd (sometime after 9 August 2013) this phone call would be fresh in her mind. RHJ Ltd therefore, rather than phoning HMRC again, phoned up CCL to ask for an explanation.

262. The explanation that RHJ Ltd received from CCL was that the letter was a mistake, that CCL had phoned up Wes Macdonald at HMRC, and that the matter would be sorted soon. That explanation was not true, but at that point RHJ Ltd did not know this. The explanation appeared plausible to them as they had (they believed) received a letter in error in regarding McGrails Scrap Metal & Recycling. The company had been deregistered and then re-registered a short time afterwards.

263. HMRC point out that firstly, the McGrails letter was not a mistake (because the company had been deregistered and re-registered) and secondly, that RHJ Ltd should not have accepted information from CCL Ltd as true.

264. On receipt of a second tax loss letter about CCL Ltd, RHJ Ltd immediately stopped trading with them.

265.

KNEW OR SHOULD HAVE KNOWN - DISCUSSION

266. The Tribunal is very mindful of the case law in this area. The case law makes it clear that the totality of the evidence should be reviewed, not merely taking everything point by point, but looking at it all together. In addition, the case law makes it clear that the 'should have known' test is a high hurdle. It is not sufficient it was more likely than not that the transaction was connected to fraud. It requires that fraud is the only reasonable explanation. This does not mean that the Appellant needs to know how the fraud was carried out. Nor does it mean that HMRC should, of their own volition, consider and rule out all other possibilities. But where there is another reasonable explanation for the transaction then this should be considered, by HMRC and by this Tribunal, before reaching a decision.

267. During the hearing HMRC attempted to show that it was possible that the Appellant knew that a fraud was being committed. The main points that HMRC raised to try and show this were to try to demonstrate that weaker due diligence had been performed on BMC and CCL than on other companies, and to try to elicit evidence that the senior management team at RHJ knew of the disqualification of Craig Cooper and knew that the Cooper companies had a history of failing and owing money to HMRC.

268. HMRC did not make these points out. They produced no evidence to back up either point, and under cross examination all the witnesses for the Appellant were firm on all relevant points. BMC and CCL were subject to the same due diligence as other suppliers. None of the senior management team had dealt with Craig Cooper in relation to BMC, nor knew of his disqualification, and none knew of any reason to be suspicious of the Cooper family companies.

269. We find that the Appellant did not know of any fraud at either BMC or (though we have not found a fraud did happen) at GPSE (which, in any case, was not known by the Appellant to be involved in its supply chain).

270. We then turn to the 'should have known' test. We have considered a number of relevant factors here, which we list below and then consider in totality.

Nature of the transactions

271. It is not suggested that there is anything in the nature of the transactions themselves that should have alerted the Appellant to anything suspicious. The material bought by the Appellant from the relevant suppliers was material that it bought from any number of suppliers in the

ordinary course of business. It was material that, in the case of CCL, it had been buying from that supplier for a number of years, and in the case of BMC, it had bought from Towmasters for a number of years.

Knowledge of MTIC fraud in the scrap metal industry

272. It is very clear from all the evidence that HMRC has, for a number of years, engaged with scrap metal dealers on 'the problem of MTIC fraud within the scrap metal industry'. However, despite hearing from a number of HMRC officers during the course of this hearing, we are not clear exactly what message HMRC gives the scrap metal dealers it educates. We are also not clear why HMRC gives the label 'MTIC fraud' to situations such as the frauds or potential frauds involved here. These frauds do not involve a missing trader or any intra-community trading. At the very simplest level, they involve a trader deciding to default on VAT obligations.

273. We have heard from the Appellant that they understood HMRC to be asking them to look out for unscrupulous new suppliers entering into the market. They also understood HMRC to be saying that sometimes these new suppliers had previously dealt in mobile phones. We know that the Appellant did get approached by suppliers offering deals that were 'too good to be true' and refused them. We know that on one occasion RHJ informed HMRC of the details of one such supplier, and never heard anything back from HMRC.

274. The Appellant has told us that HMRC did not discuss with them any concerns about 'phoenix' type frauds.

275. We know that HMRC handed out Notice 726 to the Appellant many times. It is common ground that large parts of this notice are irrelevant to the scrap metal industry, and we know that parts of the notice details factors that could lead to a suspicion of fraud (fixed profit margins, buyer and seller knowing each other, pricing oddities) were not present in these transactions.

276. We have heard from the Appellant that they took their obligations seriously and attempted to ask HMRC questions about what they should do, for example what credit checks on a supplier could tell them. We have heard that the main answer from HMRC was 'look at notice 726'.

Attitude towards tax loss letters

277. We have heard from HMRC that the fact that the Appellant carried on dealing with CCL after receiving a tax loss letter naming them is an indication that the Appellant should have known that there was a fraud going on.

278. We have heard from the Appellant that their usual policy was to stop dealing with suppliers once a tax loss letter was received.

279. We have also heard from the Appellant that HMRC made it very clear to them that they could not advise RHJ to stop dealing with any supplier, and that was a decision for RHJ. We can see from the timeline of events that HMRC last gave that advice to RHJ around a week before the first tax loss letter relating to CCL was received.

280. We consider that the method that RHJ used (phoning CCL and taking their word as true) was not ideal, but we consider bearing in mind all of the other facts surrounding the situation that it was understandable. We do not consider that it equates to RHJ 'turning a blind eye'.

281. When a second tax loss letter was received, RHJ immediately ceased dealing with CCL.

Dealing with the Cooper companies

282. We have heard from HMRC that they consider RHJ should have been suspicious that companies run by Chris Cooper and his family were often run for a short period of time and then succeeded by another company.

283. Bearing in mind the intermittent trading history between RHJ and the Cooper family companies, we consider that the only relationships this is relevant for are those between RHJ and Towmasters, BMC and WM Darleys. RHJ traded with Towmasters from February 2010 until April 2013, when it stopped dealing with Towmasters and started dealing with BMC. RHJ undertook checks on WM Darleys in November 2013 and started trading with it in 2014.

284. RHJ was told by Chris Cooper that he had bought BMC for the assets and intended to merge the trade with Towmasters. It is clear from what Chris Cooper told HMRC that BMC did have assets that Chris Cooper wanted to use. We do not consider that the change of company, given the reasons stated to RHJ, should have given a cause for concern. RHJ performed its due diligence on BMC (this is discussed further below) including, during the period of trading, visiting the site, and did not class BMC as a company they ought to be suspicious of as a 'new entrant to the market' as they knew Chris Cooper had a long history in the scrap metal trade.

285. The WM Darleys transactions took place after the relevant period of time here. However, we consider them in case the willingness of RHJ to trade with another Cooper company is an indication that they may have known the modus operandi of Chris Cooper and yet continued to trade with his companies.

286. RHJ bought from WM Darleys from early 2014. The type of material is exactly the same as that previously bought from the other Cooper companies. We were not provided by either side with an explanation of why the trading shifted from BMC. Ms Greasley mentioned that from October 2013 BMC had become increasingly insistent about receiving payments.

287. On the evidence provided, we do not think that starting to trade with W M Darleys amounts to a significant point regarding potential fraud by BMC.

Cooper family

288. We have found no evidence that shows that any of the senior team at the appellant should have known any adverse facts about any of the Cooper family. This is discussed further under 'Due diligence' below.

Due diligence

289. We accept HMRC's point that the due diligence performed by RHJ, was, from the point of view of enabling it to spot VAT fraudsters, not perfect. We accept the point made by the appellant that the due diligence was, from the point of view of credit risk to the Appellant, sufficient.

290. HMRC points out that the Appellant was provided with notice 726 many times, and this clearly says due diligence should be performed on suppliers.

291. The Appellant points out that the notice refers to 'new' suppliers, and that CCL was not a new supplier, and that BMC, whilst a new supplier, was not run by a new entrant to the market.

292. HMRC say the Appellant should have refreshed the checks annually, which they did not, and further point to the fact the Appellant told HMRC they did.

293. The Appellant say that they checked annually to see whether anything material had changed at the supplier, and if it had, new due diligence would have been performed, and that this is consistent with what they told HMRC.

294. Having accepted that the due diligence was not perfect, and that RHJ has an obligation to mitigate as far as possible the risk of VAT fraud in the supply chain, we then turn to what additional due diligence would have been possible, and what it would have shown.

295. Firstly, in the matter of credit checks. HMRC made the point extensively that CCL and BMC had a nil advised credit rating. They also (erroneously) tried to show that the companies were in a net liability position, which in fact was not the case for the latest filed accounts for either at the time that due diligence would have been performed.

296. It is clearly not the case that a nil credit rating is evidence of VAT fraud.

297. It is true that a nil credit rating is not desirable, and may have led to further questioning. It is not, however, evidence that the Appellant was unwise, in a business sense, to deal with the companies, as the Appellant was not extending them credit. In the case of BMC, we know that they told HMRC that their business model was to receive cash in from their customers (ie RHJ) before they paid their suppliers. Therefore BMC did not need to be able to obtain credit to run their business.

298. In the case of CCL, a known nil credit rating at the time of first supply would probably have led to caution in dealing with them until a trusted relationship had been built up. A known nil credit rating in 2013 when they had built up that relationship for 4 years would not have been such a cause for concern.

299. In the matter of any further due diligence that may have been expected, we treat with caution HMRC's assertion that details of failed companies and other directorships of the directors would have been easily available. The Tribunal is not convinced that in 2013 such information would have been as easily available as it may be today.

Overall background

300. As part of the totality of the evidence we consider the conduct of the Appellant at the time of the transactions:

301. We know that they were cooperative with HMRC and that contemporaneous HMRC accounts praise their due diligence.

302. We know that they passed on to HMRC details of a trader they considered to be suspect.

303. We know that during police investigations surrounding the industry they were fully cooperative and no concerns were raised.

304. We know that they had implemented cheque payments to improve VAT traceability before these became mandatory.

305. We know that they requested photo ID from traders selling lead, long before it became a legal requirement.

306. We know that they were aware of the value of their reputation and sought to uphold that and protect it against damage.

307. Against this, we consider HRMC's concerns that weighbridge tickets were not kept. The Appellant has explained that for the non-ferrous business weighbridge tickets were not the controlled document, as the loads were often mixed and metals were then weighed more accurately on smaller scales.

308. We consider that HMRC has not made out that the Appellant should have known that there was fraud in the supply chain. The totality of the evidence points to a company that did its best, engaged with the process and HMRC officers, and went about its ordinary course of business. Even had the due diligence been more thorough, it would not have revealed anything

that would have indicated a fraud. The most that would have been revealed would have been businesses operating with commercial uncertainty. However, due to the history that RHJ had in dealing with either the specific business, or knowing that the individual behind the business has long-standing in the industry, this would not have been a significant indicator of fraud.

OTHER GROUNDS OF APPEAL

309. We now turn briefly to the first two grounds of appeal raised by the Appellant. In the light of our decision in other areas we will not dwell on these points extensively.

310. The Appellant submits that the decision was not competent, and was not made to best judgement.

311. In relation to the competence of the decision, (and the subsequent assessment), the relevant legislation is at s73 (1) of the Value Added Tax Act 1994.

312. This says (our italics)

> 73Failure to make returns etc.
>
> (1)Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns *or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.*

313. What is needed for a competent assessment is that it has appeared to the Commissioners that a return is incorrect. It then is necessary for the Commissioners to make an assessment to the best of their judgement.

314. The Appellant submits that there is not the required evidence that HMRC have 'taken the decision' necessary for the assessment. They further submit that the burden of proof is on HMRC to show that the decision has been taken.

315. The Appellant submits that as it is not clear that a decision had been taken that BMC, or GPSE, were fraudulent defaulters, it further means that a decision was not taken that the returns of RHJ were incomplete or incorrect.

316. Whilst it was clear from the evidence from HMRC that there was a lack of clarity over who had taken what decision when, in relation to whether a particular company was a fraudulent defaulter, we do not consider that is relevant in relation to the competence of this assessment.

317. It is abundantly clear to the Tribunal that the Commissioners think, and at all relevant time thought, that the returns were incorrect (as they claimed input VAT which was not properly recoverable due to fraud).

318. The legislation does not require any more than this.

319. The Appellant further submits that the assessment was not to best judgement. For this ground of appeal we start with the decision letter itself. This was issued on 17 July 2015 and, so far as is relevant, it says:

> 'The European Court of Justice, in its judgment in the joined cases of Axel Kittel v Belgian State and Belgian State v Recolta Recycling SPRL (C-439/04 and C440/04), stated that a taxable person knew or should have known that it

was participating in a transaction connected with fraudulent evasion of VAT, that taxable person's right to deduct input tax should be refused.

Having undertaken an extended verification of the transactions set out in the attached appendix, the Commissioners are satisfied that those transactions are connected with fraudulent evasion of VAT. Furthermore, the Commissioners are satisfied that Ronald Hull Junior Limited knew or should have known that this was the case.....

...In the making of this decision the Commissioners have taken into account the features of trade evident from reviewing the transactions and activities of Ronald Hull Junior Limited, including:.

a) The transactions under consideration have been traced back to identified fraudulent tax losses in the appropriate VAT periods.

b) Starting in 2008, and prior to the transactions under consideration taking place, Ronald Hull Junior Limited:

- received letters notifying of tax losses in previous periods ;
- received three visits at which MTIC was discussed; and
- was given a copy of Notice 726 – Joint and several liability;

Ronald Hull Junior Limited can therefore be shown to have had a general awareness of VAT fraud prior to entering into the transactions under consideration, including the need to take reasonable steps to establish the credibility and legitimacy of its customers, suppliers and supplies.

Despite these warnings you continued to purchase from supply chains that were connected with fraud. I have concluded that this was because Ronald Hull Junior Limited knew or should have known all along that these suppliers and supplies were connected with fraud.

c) Despite the high value of the goods being purchased and sold Ronald Hull Junior Limited confirmed that they did not enter into any formal written contracts with Barnsley Metal Company Ltd. Neither have I received any information to suggest that formal contracts were exchanged in relation to the purchase of goods from Carwood Commodities Ltd. This means that, for the transactions under consideration, matters such as transfer of title, payment and delivery terms were not subject to any formal agreement. It would be expected that a business carrying on a normal commercial trade would ensure that redress in such cases would be set out in a formal written agreement, if for no other reason than in case of legal dispute. I have concluded that Ronald Hull Junior Limited knew it would not need formal contracts because it knew the transactions were connected with fraud.

d) Despite my requests Ronald Hull Junior Limited has been unable to provide me with the documentation that a reasonably diligent trader operating in this sector would be expected to keep, including weighbridge tickets, and details of the onward supply of goods. You have said that these records were not retained. Either they were not retained by Ronald Hull Junior Ltd, or they were retained but you have decided not to provide them to HMRC. Either way I have concluded that you did not want to provide these records because you were concerned that they would reveal that Ronald Hull Junior Ltd knew or should have known that the transactions in the Appendices 1, 2 & 3 were connected with fraud.

e)[Outline of due diligence performed]...Ronald Hull Junior Limited did nothing to confirm, via third party checks and reports, that its suppliers were credible, solvent businesses that would honour their trading commitments. I have concluded that Ronald Hull Junior went through the motions of due

> diligence with the objective of demonstrating compliance with HMRC. Ronald Hull Junior Limited had no requirement to carry out meaningful checks any event because it knew that its suppliers and supplies were connected with fraud.

320. When giving oral evidence, Mr Payne said, in relation to point a), that he did not himself make the decision that BMC was a fraudulent defaulter. He thought that Miss Raglan (now Mrs Martin) had made that decision. Mrs Martin, however, said she had not made that decision. Mr Payne thought that Mr Thompson had made the decision that GPSE was a fraudulent defaulter, however Mr Thompson said that he had not made that decision.

321. In relation to point b), Mr Payne confirmed that he had not taken into account, when making the decision, any factors that would point against RHJ knowing or having means of knowledge of any fraud.

322. In relation to point c), Mr Payne confirmed that he had not seen any contracts with any of RHJ's other suppliers. He confirmed that he had been told by RHJ that they did not have written contracts with any of their suppliers as the trades were 'spot' trades, that is, a supplier turns up with the goods, the price is agreed at that point, RHJ takes the metal, and then a BACS payment is made for the goods. RHJ (and other scrap metal dealers) therefore have little need for formal contracts as there is little risk involved for them. Mr Payne was taken to a meeting note of another HMRC officer in which the officer explained, to RHJ, that the reason the scrap metal industry was targeted by fraudsters was that it was common not to have contracts. Mr Payne agreed, under cross examination, that the lack of a contract was therefore not an indicator that in these circumstances pointed to the likelihood of a fraud.

323. In relation to point d) Mr Payne agreed that he had been shown round the business, and fully understood that the reason the onward supply of goods could not be traced to particular purchases was because the metal went through large amounts of processing, and therefore the tracing was physically impossible. He therefore agreed it was not true to write that he should expect to see details of the onward supply of goods. He also agreed that he had been given full details of why weighbridge tickets were not kept, and what was kept instead, and it was incorrect to conclude that this was an indication of fraud. Mr Payne confirmed he was in full knowledge of these facts when he wrote the letter.

324. This clearly puts HMRC in an uncomfortable position. Mr Payne wrote a letter, putting in a variety of reasons for his decision, many of which he now admits were, to put it in the best possible light, exaggerated.

325. The Appellant submits that this means that the assessment was not to best judgement.

326. HMRC submits that this is not relevant to the best judgement of the assessment. What HMRC did was to consider the invoices raised by suppliers where HMRC believed there was a connection to fraud, and to deny the VAT on those invoices.

327. Again we agree with HMRC here. Whether or not Mr Payne's reasons in his letter stand up to scrutiny, the method employed by HMRC when coming to a best judgement of the assessment did not rely on, for example, whether or not RHJ should or should not have had written contracts with suppliers. It relied on what were the value of the purchases and the VAT on that amount.

328. We therefore dismiss this ground of appeal.

THE DECISION

329. The matters we had to decide were:

330. In relation to GPSE, was it a fraudulent defaulting trader?

331. In relation to RHJ Ltd's trade with CCL, was there a connection to CCL's trade with GPSE?

332. In relation to CCL, did RHJ Ltd know, or should they have known, that the transactions RHJ Ltd entered into were connected to fraud?

333. In relation to BMC, was it a fraudulent defaulting trader?

334. In relation to BMC, did RHJ Ltd know, or should they have known, that the transactions RHJ Ltd entered into were connected to fraud?

335. Our decision is that:

336. GPSE was not a defaulting trader. The most likely explanation for the default by GPSE Ltd is that the business failed due to the deregistration by HMRC.

337. We have also considered the remaining questions in relation to the trade with CCL, in case there is a fraudulent trade in the CCL chain before GPSE. We find that HMRC have not shown that there is a connection between sales made by CCL to RHJ Ltd and purchases made by CCL td from GPSE Ltd. We find the length of time between the purported connected transactions improbable.

338. We find that RHJ Ltd did not know and should not have known that connections with CCL were connected to fraud. We do not consider any of the transactions contained any factors which should have alerted RHJ Ltd to the possibility of fraud. We consider that even if RHJ Ltd had conducted more extensive due diligence it would not have found any conclusive factors.

339. We find that BMC was a defaulting trader. Its transactions with HMRC were dishonest and the controlling minds had a history of similar frauds.

340. We find that RHJ Ltd did not know and should not have known that its transactions with BMC were connected to fraud. To RHJ Ltd these transactions were in the ordinary course of its business, there was nothing in the transactions themselves that were suspicious. RHJ Ltd did not have the means of knowledge to uncover the history of the Cooper family businesses and further due diligence would not have revealed conclusive indicators of fraud.

341. For the above reasons, the appeal is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

342. 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.

SARAH ALLATT
TRIBUNAL JUDGE

RELEASE DATE: 04 FEBRUARY 2020