

3 more VAT fraud cases

The never ending battle that is MTIC litigation continues with advance followed by reverse with a monotonous inevitability.

The Tribunal's decision in Blue Sphere in May of this year marked a welcome recognition that traders doing business in one part of the sales chain may not be aware of fraudsters operating in another part of the chain. The Judge in Blue Sphere mounted an attack on the way HMRC had presented its case arguing that Blue Sphere ought to have known of the connection to fraudulent transactions through the fraudster Infinity which was trading several trades removed from Blue Sphere and after Blue Sphere's trade had been completed. It was this unrealistic approach on the part of HMRC which appears to have swayed the Judge against Customs. There are two separate questions involved:

- * Knowledge of the connection; and
- * Knowledge that that connection was with the fraudulent evasion of VAT

The Judge took the view that whilst Blue Sphere would have known that its transactions would be connected with traders later in time that alone was not enough to establish that Blue Sphere knew or ought to have known that those other, subsequent transactions involved the fraudulent evasion of VAT.

The Judge held that the Tribunal was wrong to say failure to follow up unsatisfactory outcomes from Blue Sphere's due diligence was not sufficient to protect it from the risk of involvement in transactions which might turn out to be undesirable. This was the wrong test. It is not whether such transactions "might turn out" to be undesirable but whether Blue Sphere ought to have known it was participating in the fraudulent evasion of VAT.

So, a victory for common sense perhaps, however the decision is being appealed by HMRC.

Customs have begun to look more closely at the operating methods adopted by traders. Paying lip service to fraud prevention steps such as due diligence will be used as evidence of participation in VAT fraud. Typical arguments now being used by the Customs were reviewed in the October 2009 judgment in Red 12 Trading Limited (Red 12) where once again the issues of "connection" and "knowledge or constructive knowledge" were put under the spotlight. HMRC focussed on trading behaviour rather than the more theoretical notions of connection which they argued in Blue Sphere.

The characteristics of Red 12's trading activities established knowledge of fraud:

- * There were no records of any of the (said to be) extensive emails and telephone calls leading to each of 46 deals entered into by Red 12

- * The trading patterns made no commercial sense
- * Red 12's terms of business were inconsistent with its trading practices
- * In 21 of the 46 deals inspection reports were dated more than a day after the deal date
- * A large proportion of the stock had 2 pin chargers suitable for use on the European mainland but were being imported for sale in the UK where 3 pin chargers were needed
- * No customer ever rejected a phone
- * Red 12 did not take down any of the IMEI numbers of the phones and its accountant's advice to do so had been rejected

Unsurprisingly, perhaps, Red 12 lost its claim to repayment in the High Court.

The most recent case was reported on 6 November: Megtlan where Lewison, J. held that a company which had been left penniless after a repayment claim had been refused should nevertheless pay £40,000 on account of HMRC's costs if they succeeded. The case has not yet been fully reported and it will be interesting to see how the defences to such claims for security were addressed by the Learned Judge. In this case the presence of a third party funder (a director of Metgiant) appears to have been significant and could hold important consequences for all third party funders involved in MTIC litigation.

Finally a word about the covert activities of HMRC in undertaking covert inspection of transports to ascertain whether they are actually carrying phones or not. In one recent case our client was shocked to discover that of the 3 lorries in her convoy Customs found 2 were empty and one filled with shredded paper.

Make sure your internal procedures are tight and effective. This is the latest battleground. In cases of uncertainty seek advice before entering into deals.

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