



Neutral Citation: [2023] UKFTT 00403 (TC)

Case Number: TC08808

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Heard at Taylor House, London

Appeal reference: TC/2015/02184
TC/2016/02974

VAT: denial of input tax on transactions connected with fraud, whether Elbrook knew or ought to have known transactions connected with fraud.

Heard on: 18 November to 2 December 2022

Judgment date: 28 April 2023

Before

**TRIBUNAL JUDGE GETHING
Ms CATHERINE FARQUHARSON**

Between

Elbrook (Cash & Carry) Limited

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Tim Brown, of counsel, instructed by Rainer Hughes

For the Respondents: Mr Howard Watkinson and Mr Joshua Carey of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. Elbrook (Cash & Carry) Limited (“**Elbrook**”) appeal against two assessments made by HMRC to deny deduction of VAT input tax of £1,273,739.55 claimed in respect of 335 transactions to purchase soft drinks in the VAT periods ending 04/12 to 07/14 on the ground that the purchases of the soft drinks are transactions connected with fraudulent evasion of VAT and that Elbrook knew or should have known they were so connected.

2. In respect of 331 of the 335 transactions it is not in dispute the fraudulent evasion of VAT arose pursuant to an orchestrated scheme whereby the trader, at the start of each of the 331 of 335 chains of transactions to which Elbrook was party, failing to account to HMRC for output tax on the sale of the soft drinks. HMRC state that there was an orchestrated scheme to fraudulently evade tax in respect of all 335 transactions and that the three suppliers to Elbrook were engaged. The three direct suppliers are Golden Harvest Wholesale Limited (“**Golden Harvest**”), Horizon Traders Limited (“**Horizon**”) and DZ Distribution Ltd (“**DZ**”). HMRC identify ten strands of evidence and invite the Tribunal to find that the 335 transactions to which Elbrook was a party were connected to that orchestrated fraud, and that either Elbrook knew that the 335 transactions were connected with fraud or, that in all the circumstances Elbrook ought to have known that the only reasonable conclusion is that transactions were connected to the fraudulent evasion of VAT.

3. Elbrook agree that there has been loss of VAT to HMRC in 334 of the 335 transactions but: Elbrook considers there was no loss of VAT in relation to a transaction involving Sparrowhawk Ltd (“**Sparrowhawk**”).

(1) Elbrook does not accept that the 4 transactions involving DZ Distribution Ltd (“**DZ**”) were part of an overall scheme to defraud HMRC.

(2) Elbrook states that it neither knew nor ought to have known that any of the 335 transactions were connected with fraudulent evasion of VAT. Elbrook states it is a reputable company and reputable companies can get caught up in criminal activity. Just because Elbrook was at the end of the chains does not justify the inference that Elbrook knew of the activities of those higher in the chain. Elbrook suggests that there must be an honest taxpayer at the end of chain paying VAT for the fraud to be effective.

(3) Elbrook note that the burden of proof is on HMRC to establish that the conditions for denial of input tax are satisfied on the ordinary civil standard of a balance of probabilities. Elbrook say that there is no direct evidence that Elbrook knew or ought to have known that its 335 transactions were connected to the fraudulent evasion of VAT, and that circumstantial evidence would be insufficient to reach the threshold of proof.

4. HMRC had revoked Elbrook’s registration as a Registered Owner of Duty Suspended Goods under the Warehousekeepers and Owners of Warehoused Goods Regulations 1999 (“**WOWGR**”) under Section 100G(5) of the Customs & Excise Management Act 1979. Elbrook had appealed the decision to revoke the registration but withdrew the appeal on 30 September 2022 as Elbrook had sold the business and therefore no longer needed the registration. As the WOWGR appeal had been run in tandem with the appeals under consideration some of the evidence assembled by HMRC primarily for the WOWGR appeal is also relevant to some of the issues in these appeals.

THE LAW

5. A taxable person **P** has a right to deduct from VAT it must pay to HMRC (output tax), the VAT incurred on goods acquired by **P** (input tax) and used to make a taxable supply by **P**. The right arises under Articles 167 and 168 of Council Directive 2006/112/EC.

6. That right is embodied in sections 24, 25 and 26 of the Value Added Tax Act 1994 (“the **VATA**”) which give **P** the right to a credit for VAT paid on the purchase of goods and to deduct that VAT from VAT payable by **P** on sale of goods by him. The manner of making a claim for input tax deduction in returns and by reference to VAT periods (usually quarterly periods) is set out in Regulation 29 of the Value Added Tax Regulations 1995 (SI 1995/2518).

7. The general rule is that the credit for input tax paid is due and must be set against out-put tax due in a VAT period and the credit is repayable if the aggregate input tax paid exceeds the output tax payable in any period. The general rule is modified by the decision of the Court of Justice of the European Union (CJEU) in the joined cases of *Axel Kittel v Belgium* and *Belgium v Recolta Recycling SPRL* C-439/04 and C-440/04 (“**Kittel**”). There is no right to deduct where the taxable person “*knew or ought to have known*” that the purchases on which input tax was incurred were connected with the fraudulent evasion of VAT.

8. And at [62] the CJEU said, “*Where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct.*”

9. Moses LJ in the Court of Appeal in *Mobilx (in liquidation) v HMRC* [2010] EWCA Civ 517 (“**Mobilx**”) commented on the lack of need to prove a culpable state of mind of the taxpayer claiming the deduction before the court can deny the right to deduct input tax. He said at [52] that if a taxpayer has at his disposal means of knowing that by buying goods he is participating in a transaction connected with fraudulent evasion of VAT, it is immaterial that under the domestic law of the UK, complicity in fraud denotes a more culpable state of mind. He said, “*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.*”

10. At [59] Moses LJ commented that the *Kittel* principle denies the right to deduct if a person knows or “*should have known*” of the connection with fraud. He states “*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 fraudulent evasion of VAT then he should have known that fact. He may properly be regarded as a participant [in the fraud] for the reasons explained in Kittel.*” (our insertion).

11. At [83] Moses LJ cited the case of *Red 12 Trading v HMRC* (“**Red 12**”) [2009] EWHC 2563 Christopher Clarke J at [110] where he pointed to the following features of transactions:

- (1) “*compelling similarities between one transaction and another*”
- (2) “*pattern[s] of transactions*”
- (3) “*transactions all of which have identical mark ups*”
- (4) “*...made... as part of a huge and unexplained turnover*”
- (5) “*with no left-over stock*”

and reached the conclusion that “*A tribunal could legitimately think it unlikely that the fact that all 46 transactions in issue can be traced to tax losses by HMRC is a result of innocent coincidence.*”

Further in considering what the trader ought to have known, the “*Tribunal is entitled to look at the totality of the deals effected by the taxpayer (and their characteristics), at what the taxpayer did or omitted to do, and what it could have done, together with the surrounding circumstances.*”

12. Moses also stated in *Mobilx* that:

- (1) If a trader should have known from the circumstances that a transaction was connected with fraud, the trader shall for the purposes of denying input tax be treated as having directly and knowingly been involved with fraud. [64]
- (2) The focus should not be on whether the trader has acted with diligence. Even if a trader has asked questions, he is not entitled to ignore the circumstances in which his transactions take place if the only reasonable explanation for the transactions is that they are connected with fraud. [82]
- (3) Questions the trader should ask include, “why are various people encouraging the appellant to become involved in the transactions. What benefit might they be deriving by persuading the appellant to do so? Why should they be inviting the appellant to join in when they could make the profit themselves? [83]
- (4) If a trader chose to ignore the obvious explanation of why he was being offered the opportunity to reap a large profit over a short period of time, that would be a significant fact. [84]

13. It is not necessary for a taxpayer to be dishonest (see *HMRC v Citibank NA, E Buyer UK Limited* [2017] EWCA 1416 at [90] or for the taxpayer to know the identities of the fraudulent defaulters (see *Megtian Ltd (In Administration) v HMRC* [2010] EWHC 18 CH [37-38]

14. Arden LJ said in *Davis & Dann Ltd & Another v HMRC* [2016] (“*Davis & Dann*”) EWCA Civ 142:

14. taxpayer may have knowledge to the “only reasonable explanation” standard if he fails to make enquiry [64]
14. the Tribunal should be wary of compartmentalising the evidence [60]
14. the Tribunal is not restricted from relying on any circumstance which is capable of being probative as to knowledge [62].

15. On ordinary principles, Elbrook’s state of knowledge can be determined from the state of knowledge of Mr Khalid, a director of Elbrook.

16. Most the VAT Act 1983 is given over to the entitlement to be registered for VAT and the mechanics of enabling VAT recovery. The first decision of the CJEU on deregistration was handed down on 14 March 2014 and referred to as *Ablessio* C-527/11 (“*Ablessio*”).

Statutory Records

17. Section 386 Companies Act 2006 requires companies to keep adequate accounting records sufficient to show and explain the company’s transactions. Section 386(4) states that if the company’s business involves dealing in goods the accounting records must contain:

- “(a) statements of stock held by the company at the end of each financial year of the company,
- (b) all statements of stocktakings from which any statement of stock as is mentioned in (a) has been or is to be prepared,
- (c) “

Section 387 Companies Act 2006 states that it is an offence to fail to retain these records.

THE FACTS

18. We received evidence from each of the following individuals, each of whom provided witness statements and were subject to cross examination.

(1) Mr Piers Craig Ginn, currently a Senior Officer of HMRC based at Dover. He has worked for HMRC and its predecessors since 2000. In 2006 he was involved in the Missing Trader Intra-Community (“*MTIC*”) fraud team at Dorset House London, he moved in 2008 to the MTIC Broker team. From 2011 to 2013 he was assigned to the MTIC team in Maidstone and from 2013 he has been a member of the large case Alcohol team at the same address. Mr Ginn provided the Tribunal with 4 witness statements made on 7 August 2017, 31 January 2018, 29 October 2019 and 17 December 2020. Mr Ginn gave evidence about Elbrook: the company, its business and background, its turnover and VAT returns, the decisions to deny input tax, the connections between Elbrook and the fraudulent tax losses and the contrived trading arrangements. We consider Mr Ginn to be an honest and reliable witness.

(2) Mr Peter Howard Dean, a Higher Officer of HMRC based in Reading. Since 2006 Mr Dean has worked in compliance teams dealing with the civil investigations of MTIC fraud. He had worked in sectors commonly targeted by organised criminal gangs including wholesale electronic and alcoholic beverage sectors. He is currently part of Fraud Investigation Service (“*FIS*”) and was previously part of Investigation Service (“*IS*”) both responsible for conducting investigations into MTIC and other serious tax fraud. He assumed responsibility for the investigation into Golden Harvest one of the three suppliers to Elbrook in January 2013 and began a verification of Golden Harvest’s VAT declarations in April 2013. The case had previously been worked by the Finchley Alcohol Team. Relations between that team and Golden Harvest broke down. Mr Dean made a witness statement dated 13 September 2017 concerning Golden Harvest. We consider Mr Dean was an honest and reliable witness.

(3) Mr Thomas Barr an officer of HMRC made a witness statement dated 19 October 2022 and adopted the witness statement of Mr Stephen Pawlis dated 23 March 2021 who in turn had adopted the witness statement of Mr Whelan dated 15 September 2017. Both Mr Pawlis and Mr Whelan were officers of HMRC when they made their witness statements and have since retired. Mr Barr gave evidence relating to DZ. We consider Mr Barr was an honest and reliable witness.

(4) Ms Jennifer King, officer of HMRC based in Stratford who made three witness statements dated 24 July 2017, 5 August 2021 and 21 October 2022. She gave evidence concerning the trader Sparrowhawk. We found her to be an honest and reliable witness.

(5) Ms Jane Elizabeth Humphry, a senior officer of HMRC in the FIS, formerly based in Slough and now in Maidstone. Ms Humphrey made three witness statements dated 25 May 2016, 16 December 2016 and 6 July 2021. Ms Humphrey took the decision to revoke Elbrook’s WOWGR licence to hold alcohol in a duty suspended warehouse. We found Ms Humphry to be an honest and reliable witness.

(6) Mr Christopher Haynes an officer of HMRC who made a witness statement adopting the witness statement of Mr Martin John Mayes dated 23 May 2016. He gave evidence about Elbrook’s claim to recover VAT in respect of the purchase, demolition and reconstruction of a property not owned by Elbrook. We found Mr Haynes an honest and reliable witness.

(7) Mr Cole, a Higher Officer of HMRC, has worked in HMRC and its predecessors since 1987. He has been engaged solely in teams whose responsibility was to identify and act upon MTIC fraud. He made a statement concerning Horizon Traders Ltd (“*Horizon*”). We found Mr Cole to be an honest and reliable witness.

(8) Mr Amjad Khalid who was appointed a director of Elbrook in 2002 and had over 10 years’ experience of working in the cash and carry business in the period under consideration. Mr Khalid made a single witness statement in 2017. We comment on Mr Khalid’s veracity as a witness when considering the evidence below.

(9) Mr Keith West a former account manager of a company that became a subsidiary of the merged group GlaxoSmithKlein plc (“*GSK*”) which at the material time manufactured soft drinks including Lucozade. He provided a witness statement dated 10 November 2017 and gave evidence about his role as account manager at GSK looking after the Today Group, a collective of European cash and carry enterprises of which Elbrook was a member, and the system of discounts offered by GSK. He also gave evidence of the pricing of soft drinks in the cash and carry sector although he was not directly involved in the sales to Elbrook or any other member of the Today Group and was not an expert witness. Mr West ceased to be employed by GSK in 2014. He was not GSK’s representative at the hearing. We comment on the quality of Mr West’s evidence below.

We find the facts as set out in this paragraph [18] and at [19] to [190] below.

Elbrook’s Business and business records and processes

19. Elbrook’s main business, that it has carried on since 1984, is a cash and carry business selling food, tobacco, alcohol, confectionery and soft drinks with a turnover of £95m in 2009, rising to £143m in 2013 before falling to £120m in 2015. Elbrook was registered for VAT on 1 October 1984.

20. Elbrook’s principal place of business since 1994 was at 105 Bond Road, Mitcham, Surrey. It comprises a large warehouse and offices above.

21. Mr Amjad Khalid was appointed a director in 2002. During the VAT periods ended 01/12 to 07/14 the directors of Elbrook were Mr Fukhera Khalid and his brother Mr Amjad Khalid. Mr Amjad Khalid was responsible for the purchases of soft drinks made by Elbrook. References in this decision to Mr Khalid are to Mr Amjad Khalid unless otherwise indicated.

22. Elbrook purchased soft drinks from each of Golden Harvest, Horizon and DZ in the periods in question. Elbrook also purchased some soft drinks directly from GSK and Coca Cola Enterprises Limited (“*Coca Cola*”) the manufacturers of Lucozade, and coca cola (which we refer to as “coke” or “diet coke” below) respectively.

23. Elbrook had SAGE accounting software which they used for accounting purposes but did not use it to monitor sales or record/control the stock levels and had no other formal record of the stock levels. On a weekly basis a physical stock-take was undertaken by the staff using a piece of paper with two columns, one showing the stock in the warehouse the other indicating stock required. Mr Khalid approved the paper record and buyers would place orders with approved suppliers for replacement stock. A copy of the paper stock records was given to Elbrook’s accounting adviser to prepare the quarterly management accounts. Elbrook did not keep a copy for themselves and did not ask their advisers for copies of these records in advance of this hearing.

24. The software in the point of sale (“till”) system was incapable of recording what was sold to whom. The till system is incapable of generating invoices in respect of the sale of £6.4m of

the soft drinks which Elbrook says were sold retail through the cash & carry, the purchase of which is the subject of this appeal. The information from the till system was supplied by Elbrook to HMRC which Mr Ginn's colleagues in the System Evasion & Audit team analysed to determine the sales made by Elbrook in the period 1 January 2012 to 31 July 2014. The data showed that in that period of 31 months, Elbrook had sold 160,857 cases of the 12 most popular products, which is in stark contrast to the 1,028,833 cases Elbrook say they purchased in the period. This is shown in Table L to Mr Ginn's first witness statement dated 7 August 2017.

The Transaction chains, Direct Suppliers, Buffer Traders, Defaulter Traders

25. In relation to the soft drinks acquired by Elbrook in each of the 335 transactions concerned in this appeal, there was a chain of suppliers before the goods were acquired by Golden Harvest, Horizon and DZ, each of whom on-sold the goods directly to Elbrook. These three companies are referred to as "**Direct Suppliers**". There were no other direct suppliers in the 335 transactions.

26. In relation to each of 335 transactions the goods were acquired by a company and on sold directly or indirectly to Golden Harvest, Horizon or DZ. I refer to these arrangements as chains. There was a minimum of two and a maximum of four suppliers in each chain. The Appellant accepts the accuracy of each of the transaction chains identified by HMRC.

27. The trader at the beginning of the chain in each of 335 transactions defaulted in paying output VAT to HMRC. These are referred to as fraudulent "**Defaulter Traders**".

28. The suppliers between the Defaulter Trader and the Direct Supplier are referred to as "**Buffer Traders**". The Buffer Traders were all registered for VAT and functioned as a conduit in holding and transferring title to the goods to Elbrook and put distance between the fraudulent Defaulter Trader and Elbrook.

29. When the company at the beginning of a chain becomes a fraudulent Defaulter Trader, the next Buffer Trader in the chain becomes the originator of the trades and it in-turn defaults.

30. Elbrook accept that there was a fraudulent Defaulter Trader at the beginning of each chain other than the chain involving Sparrowhawk. The following are the names of the Defaulter Traders: Alexis Ltd, Arete Systems Ltd, Ashneet Ltd, Blueray Enterprises Ltd, Euro Choice Ltd, Europa Cash & Carry Ltd, Gujarr Ltd, Hobbs Close Ltd, Innocent Wholesale Ltd, Logical Retail Ltd, Marjot Ltd, Mr Cash & Carry Ltd, Saad Victoria Food & Wine Ltd, Sea Inn Foods Ltd, The Person Purporting To Be ("TPPTB") Smithers Rapra Ltd, UK Beer & Wine Ltd, and Universe Drinks Ltd.

31. Sparrowhawk was the original supplier in a chain that sold soft drinks to DZ on a single occasion. Elbrook disputes that there was a tax loss caused by Sparrowhawk and therefore whether Sparrowhawk was a Defaulter Trader.

32. In all but four of the 335 transactions ("the **DZ transactions**"), Elbrook accept that the transactions were part of an overall scheme to defraud HMRC.

33. Six of the 23 companies in the chains, at the date of the hearing had been the subject to successful criminal prosecutions. They are Golden Harvest, Horizon, Alexsis, Hobbs Choice, Gujarr Ltd and Euro Choice Ltd. HMRC secured convictions of the directors of Golden Harvest and Horizon.

Criminal investigation into an Organised Crime Group ("OCG")

34. HMRC instigated a surveillance operation into the conduct of an Organised Crime Group ("**OCG**") and installed covert video and audio devices in the premises at Claremont House, Alma Road, Windsor in early October 2014. This postdates the transactions the subject of the input tax denial but records the on-going relationship between the OCG and Elbrook. The

footage records the delivery of boxes of cash, the generation of invoices for transactions between parties and the provision of bank transfers to launder cash deposits suspected to be the proceeds of crime.

35. The judge hearing the criminal case against Mr Riaz Kahn an employee of Golden Harvest and a senior member of the OCG noted of Mr Khan in his sentencing remarks that, *“The product of that device showed you [Mr Riaz Kahn] and other associates discussing and enacting the operation of the fraud in various ways, by giving instructions to new recruits on how to deal with HMRC company inspections and complete VAT returns; by processing and counting out huge quantities of bank notes brought there in boxes; by giving instructions to and from others involved; and by arranging money transfers through the network of company accounts and beyond. The footage is a window through which the elaborate and painstaking process of coordinating and creating a massive fabric of false paperwork can be seen in action.”*

36. The transcripts of the undercover operation clearly show that the OCG are involved in money laundering. One or two refer to Elbrook sending boxes or bags of money and receiving TTs. There is no mention of prices or contract terms for the sale of goods. These transcripts caused Officer Ginn to question whether the goods referred to in all of the 331 invoices with Golden Harvest and Horizon existed. The analysis of the information provided by Elbrook from the till system (see [24] above) led Officer Ginn to consider that 748,165 of the cases of soft drinks are unaccounted for.

37. One transcript of a conversation on 25 November 2014 includes statements made to the effect that Mr Amjad Khalid of Elbrook has two mobile phones and two email accounts, only one of which was to be used for the business conducted by the OCG.

38. HMRC have been able to identify the number of the second phone and confirm that it is a pay as you go phone that belongs to Mr Amjad Khalid. The second email account has not yet been detected.

39. A transcript of another recorded conversation involves one side of a telephone conversation asking whether the caller would like *“paying direct into Elbrook or do you want to do it via TT for the first few loads off you”*.

40. Another transcript records a conversation in which Riaz Kahn director of Golden Harvest refers to Mr Amjad Khalid as the **“big boss”**.

41. A further transcript of 10 February 2015 reports that Mr Khalid is not taking any further bags or boxes of cash or any transactions. He wants *“Halal”* transactions only as he is dealing with two appeals. At that date Elbrook would have received the decision letters from HMRC denying Elbrook the right to deduct input VAT and the associated VAT assessments. Elbrook had asked for a review of the decisions and assessments by 10 February and were waiting for the review conclusion letter that was subsequently sent by HMRC on 18 February 2015. Elbrook was also appealing a decision denying the deduction of input tax on building and other supplies involved in the demolition and construction of a building not owned by Elbrook.

42. Documents obtained through the criminal investigation include spreadsheets of payments to parties. One document refers to Elbrook and it being entitled to or due to pay 3% commission. Another lists 120 of the 335 transactions the subject of this appeal.

43. As a result of the investigation and prosecutions:

- (1) Mr Divyesh Karsan, director of Golden Harvest, was convicted of cheating the public revenue and sentenced on 24 May 2019 to 5 years and 2 months imprisonment.

- (2) Mr Riaz Khan, a manager of Golden Harvest (and whose recruitment was said to explain the dramatic increase in turnover of Golden Harvest) was convicted of cheating the public revenue and entering into/being concerned in the acquisition/retention/use or control of criminal property was sentenced on 24 May 2019 to 8 years imprisonment.
- (3) Mr Jayesh Shah a director of Horizon Traders was convicted on 20 December 2018 of cheating the public revenue and being concerned in the acquisition/retention/ use/ control of criminal property and sentenced to 7 years and 6 months imprisonment.
- (4) Slammed Ahmed a director of Eurochoice was convicted on 4 February 2019 of cheating the public revenue and conspiring to enter into/ being concerned with the acquisition and retention/ use or control of criminal property and sentenced to 5 years and 2 months imprisonment.
- (5) Sameer Dhanji a director of Hobbs Close Limited was convicted on 26 July 2019 of cheating the public revenue and was imprisoned for 3 years and 6 months.
- (6) Mr Fiaz Raja of Breanga Wholesalers was convicted on 27 March 2019 of cheating the public revenue and sentenced to 6 years imprisonment.
- (7) Mr Mohammed Rasool of was convicted on 29 April 2019 of cheating the public revenue and conspiring to enter into/being concerned in the acquisition/ retention /use or control of criminal property and sentenced to 8 years imprisonment.

Investigation into Elbrook, tax loss letters, decisions to deny input tax and appeals

44. HMRC commenced an investigation into Elbrook's VAT periods 01/13 to 10/13 as regards 92 transactions with Golden Harvest. A meeting was held on 9 April 2014 at Elbrook's offices between Mr Khalid, Mr Ginn and another officer of HMRC. Some of the documents that had previously been requested were provided at the meeting.
45. Correspondence followed including a telephone call on 8 May 2014 when Mr Khalid confirmed that the soft drinks acquired from Golden Harvest were sold on a retail basis through the cash and carry rather than being sold wholesale in bulk.
46. On 26 June 2014 a "tax loss letter" concerning 92 transactions in the periods 01/13 to 10/13 with Golden Harvest was hand delivered to Elbrook by Mr Ginn and explained to Mr Khalid. Correspondence ensued. A tax loss letter explains that a supplier in a chain of transactions with which the taxpayer is a party, has failed to account to HMRC for output tax. The tax loss in this case was £350,122.41.
47. On 26 September 2014 a further tax loss letter was sent to Elbrook concerning transactions with Golden Harvest and DZ relating to 53 transactions and a tax loss of £221,551.14.
48. On 10 October 2014 the implications of the tax loss letters were discussed with Elbrook and their lawyers.
49. On 22 October 2014 a further tax loss letter was sent to Elbrook concerning 52 transactions with Golden Harvest in the periods 10/13 and 01/14. The loss was calculated at £193,662.33.
50. On 25 November 2014 a further tax loss letter was sent to Elbrook in respect of 21 transactions with Horizon in the periods 04/14 and 07/14. The loss was calculated at £81,716.45.

51. On 18 December 2014 HMRC notified Elbrook of their decision to deny £771,430.20 input tax in relation to soft drinks transactions with Golden Harvest and DZ for periods 01/13 to 04/14.

52. On 6 January 2015 HMRC issued an assessment for £771,430.20 to Elbrook in respect of these transactions.

53. On 12 January 2015 Elbrook requested a review. HMRC sought additional information that Elbrook may have wished to provide to the reviewing officer. No new information was received. On 18 February 2015 the Review was concluded, and a letter was sent to Elbrook confirming the original decision to deny input tax deduction.

54. On 4 March 2015 Elbrook filed a Notice of Appeal against the assessment.

55. On 21 April 2016 HMRC issued a second decision to deny input tax in respect of £502,309.35 relating to the purchase of soft drinks in the periods 04/12 to 01/13, 04/14 and 07/14 in respect of purchases from Golden Harvest and Horizon.

56. On 22 April 2016 a notice of assessment of £502,308, relating to the input tax denial was issued.

57. On 27 May 2016 Elbrook filed a notice of appeal against that assessment.

Connections between fraudulent tax deals and losses. The direct suppliers- Golden Harvest, Horizon and DZ

Golden Harvest

58. Golden Harvest was established in 2007. Mr Divyesh Karsan (“*Mr Karsan*”) who was born in 1969 was the sole director and shareholder. Golden Harvest’s business was stated at Companies House as the “*wholesale of wine, beer, spirits and other alcoholic beverages*”.

59. Mr Karsan’s employment history indicates he had no relevant experience to begin trading as a cash and carry enterprise selling wine, beer, spirits and other alcoholic beverages.

(1) He was appointed a director of two other companies in 2000 and 2002 whose business was construction and repair of buildings.

(2) Between 2005 and 2007 Mr Karsan was employed by a car repair company.

(3) Between April and August 2006 Mr Karsan was employed at a retail convenience store.

(4) In 2009 Mr Karsan informed an officer at HMRC that he had previously worked as a plumber.

60. At the material times Golden Harvest was registered for VAT.

61. Golden Harvest was first registered for VAT on 1 February 2009 and in the form VAT1 Mr Karsan stated that the estimated turnover in the first 12 months of business as a wholesaler of wine beer, sprits and other alcoholic beverages was £100,000. The VAT threshold of £67,000 was not reached that year.

62. In 2010 the business lost its registration number because the number had been hijacked, i.e. used by another trader fraudulently. A new form VAT 1 was filed and it stated the estimated turnover in the first 12 months was £9m.

63. Golden Harvest’s turnover rose dramatically from under £67,000 in 2007/8, to £5.1m in 09/10, £31.8m in 10/11, and to £33m in 11/12. It drops off slightly thereafter. Growth in turnover on this scale in a 4-year period seems to us, and seemed to Officer Dean to be too

good to be true with only Mr Karsan employed. The explosive growth is attributed by Mr Karsan to Mr Riaz Kahn becoming employed by Golden Harvest on 1 August 2011.

64. HMRC's PAYE records show that Mr Kahn was employed by Golden Harvest, although officers visiting the premises of Golden Harvest never observed him at the premises. Golden Harvest's own adviser had informed HMRC that Mr Karsan was the only employed person at Golden Harvest. Mr Riaz Kahn was part of the OCG, was prosecuted and is now in prison.

65. The purchase orders created by Golden Harvest show that Golden Harvest bought goods from suppliers and sold them to their customers on a back-to-back basis, which involved the goods being on-sold by the original supplier to a buffer trader, from the buffer trader to the direct supplier and onto Elbrook on the same day and for the goods to be delivered by the original supplier directly to Elbrook's premises at 105 Bond Road. There were 310 such transactions involving Golden Harvest numbered 1 to 310 on HMRC's annex 2 to their submissions. The back to back sales occurred even when the supply chain extended to four companies such as Deal 139 which commenced with Mr Cash & Carry Ltd, that sold to Alexis Limited, that sold to Hobbs Close Ltd, that sold to Golden Harvest that sold to Elbrook. Each purchase order between the companies in the chain specified delivery to Elbrook's premises.

66. Golden Harvest never took possession of any of the stock. Mr Karsan considered that the supplier insured the goods and included the cost of insurance and delivery in the sale price. Mr Karsan neither confirmed nor denied if it had warehouse capacity and it seems likely that it did not. Golden Harvest's address on invoices was Unit 4 McNicolas House. The building was demolished in November 2012.

67. Golden Harvest was party to 310 of the 335 transactions.

67. The invoice date on the invoices for each transaction within each chain involving Golden Harvest occurred on the same date, save in four cases. In two of those four cases, the invoice dates were within two days of each other, and in two cases within 5 days.

67. In relation to the 272 transactions that did not include Gujjar as the supplier to Golden Harvest, the mark-up attributed to the immediate supplier to Golden Harvest ranged from 2 to 4 pence, the supplier to the immediate supplier received a mark-up of 3p save in 75 cases where there was no mark up at all, and only in nine cases did the supplier to the supplier to the immediate supplier receive a mark-up and that was 3p. The remaining 38 transactions involved Gujarr Ltd supplying goods to Golden Harvest. The invoices relating to the Gujjar transactions show larger markups of up to 10p per item, but it is notable that the supplier to Gujjar received no mark up at all.

67. The lack of mark-up credited to the supplier at the beginning of a chain ("*the originator*") seems to us to be uncommercial. The originator bears the greatest risk and if the originator has secured goods at a low price through its ingenuity/contacts, one would expect the originator to be rewarded.

68. In 105 of the 170 transactions involving Golden Harvest in 2013, where the supplier to Golden Harvest was either Hobbs Close Ltd or Alexis Ltd, the invoices provided to Elbrook have handwritten notes on them indicating that the goods had been damaged. This seems to us to be an extraordinarily high strike rate. We note Golden Harvest, Hobbs and Alexis were part of the criminal case involving the OCG.

69. In relation to the volume of damaged goods, it seems to us that if there were no goods being supplied on occasions and invoices were being issued as part of a money laundering operation to make the trade appear real, noting damaged goods on the invoices may well be thought to assist in substantiating the trade. Unless a record is being kept of the number of cases claimed to be damaged it is possible those in the warehouse may get carried away in their

zeal to make the trade appear real. Further it is difficult to understand why Elbrook would continue to purchase goods from these suppliers if the volume of damaged goods was so high. Mr Khalid said in cross examination that only one or two cans per case were damaged and it was easy to repack the cases. If the damage was so slight and it was so easy to repack it is difficult to understand why the invoices were marked up in the manner that they were. We infer from the above that the volume of real trades from Golden Harvest was smaller than the volume of purchases Elbrook claims to have made.

HORIZON

70. Horizon was incorporated on 14 January 2005. It became registered for VAT but its original VAT number was hijacked by a third party to commit fraud and a new VAT1 was submitted on 9 December 2010. Its business activity was stated to be “*wholesaler of wines, beers, spirits and other beverages*”.

71. Jayesh Shah was the sole director in the period concerned.

72. Horizon had a 2,500 square feet warehouse with offices above and an entrance into the warehouse that would accommodate a heavy goods vehicle.

73. On 20 April 2011 HMRC visited Horizon ostensibly to discuss a repayment claim Horizon had made but also to discuss the high-risk nature of the trade and the fact that Horizon’s VAT registration had been hijacked in 2010. The meeting took place at Horizon’s accountant’s offices in Mr Shah’s absence. The accountant promised to discuss the issues with Mr Shah. The repayment claim was for general running costs as there was no current trading activity.

74. On 11 December 2012 HMRC made an unannounced visit on 11 December 2012. Mr Shah was not there but they obtained his mobile phone number.

75. HMRC wrote to Horizon to inform them that the VAT registration number would be suspended due to lack of evidence of trading unless Mr Shah provided such evidence in five days.

76. Mr Shah contacted HMRC and a further visit was made on 14 January 2013. Mr Shah explained that he had been ill and had family troubles which is why there had been no trading, but he now planned to deal in shrink wrap and boxes and needed to retain his VAT registration number.

77. On 17 May 2013 HMRC informed Mr Shah that Horizon’s VAT registration had been suspended owing to lack of evidence of trading activity.

78. At a meeting on 3 June 2013 Mr Shah informed HMRC that he was fully fit and able to trade. The VAT number was reinstated.

79. Horizon’s VAT return for 08/13 claimed a repayment and the return was subject to scrutiny by Officer Reynolds of the MTIC team.

80. On 12 November 2013 HMRC visited Horizon and spoke to Mr Shah and an employee Mr Hirani about business activity and procedures, MTIC fraud and excise duty diversion fraud. Mr Shah informed the officers that Horizon had engaged Due Diligence Exchange Ltd (“*DDE*”) to undertake due diligence on suppliers. The officers formed the view Mr Shah was aware of MTIC and were in no doubt that further review of Horizon’s transactions would result in UK tax losses.

81. On the same day HMRC wrote to Horizon informing Horizon that the VAT return was to be verified as part of the strategy to counter MTIC fraud.

82. On 13 November 2013 HMRC wrote to inform Horizon of financial platforms that fraudsters used, provided information about indicators of MTIC fraud and invited Horizon to verify the VAT status of its suppliers.
83. On 4 March 2014 at a meeting at Horizon's premises Horizon produced purchase invoices from Euro Choice and Golden Harvest. The officers looked at customers and transport arrangements. The officers concluded Horizon was involved in defaulting supply chains but were there several buffer companies between the defaulting traders and Horizon.
84. On 23 May 2014 Officers informed Horizon that they were selected for a closer working visiting programme due to ongoing problems in the sales of alcohol.
85. On 30 June 2014 officers visited the premises and discussed business activity, VAT records, business set up, vehicles, cash handling, and stock control. Horizon had no stock record. Mr Shah was given Notice 726 on joint and several liability and due diligence that ought to be undertaken. The officer concluded that as he had been trading in alcohol and as alcohol is a high risk commodity frequently the subject of fraudulent transactions, Mr Shah was aware of the need to undertake due diligence on its suppliers and customers.
86. On 9 July 2014 Horizon were informed that its VAT return 05/14 was selected for verification. Officers visited the premises to collect the necessary records to do the check. Mr Shah had no invoices for the stock purchases, and he had failed to put in place a stock control sheet. The HMRC Officer noted there was very little evidence of trade and very little stock for a company with £3m turnover.
87. On 23 July 2014 officers visited the premises. Mr Shah was not present. There were only a few pallets of goods in the warehouse.
88. On 3 October 2014 Officers visited the premises. Mr Shah was absent. An employee allowed them to inspect the site.
89. On 21 October 2014 Officers of HMRC and Mr Shah met to discuss VAT period 08/14 in respect of bad debts claimed on two transactions. Officers collected records but again Mr Shah had no stock record. Officers collected VAT records and due diligence materials relating to Elbrook. The officers inspected the stock. There were only ten pallets of beer and wine on the premises.
90. A visit on Saturday 1 November 2014 revealed that the premises were not open on Saturdays.
91. The Lanyard fraud team called at the premises on 5 November 2014. Mr Shah was not present and the officers were advised to call back at 13.00. they called again at 13.20 but no one answered the door.
92. The Officers called again on 6th November to inspect the premises, there were 19.5 pallets of beer and 3.5 pallets of wine.
93. On 1 December 2014 Officers visited the premises to return the records and Horizon was given a tax loss letter concerning their customer Golden Harvest. In the warehouse were six pallets of wine and a number of pallets of beer.
94. On 26 January 2015 a number of tax loss letters were delivered concerning purchases by Horizon from Best Buys Supplies Ltd, Euro Choice, Breanga Wholesale Ltd and Golden Harvest.
95. On 4 February 2015 officers visited Horizon. The warehouse was deserted, and unopened mail was visible on the floor. Officers left a message on Mr Shah's phone and followed up

with a letter the same day, to the effect that the business was to be deregistered and if no contact was made in 7 days the deregistration would be permanent.

96. On 5 February 2015 the officers were informed by Mr Shah's accountant that on 30 January another team of HMRC officers called at the premises and removed all documents, computer, stock and mobile phones.

97. Horizon's legal team sought a reinstatement of the VAT registration number, which was refused by Officer Broers. It was however agreed that Horizon could trade up to the VAT threshold. The warehouse stock comprised shrink wrap and boxes.

98. The following tax loss letters were sent to Horizon:

(1) 24 April 2015- in respect of 21 transaction with a value of £80,496.70.

(2) 9 September 2015- in respect of 40 transactions with a tax loss of £269,966.79.

(3) 23 September 2015 in respect of 20 transactions with a tax loss of £151,709.81.

(4) 19 January 2016 in respect of 14 transactions with a tax loss of £89,680.08.

99. On 23 August 2016 an assessment denying deduction of £533,477 input tax was issued in respect of the period 08/14 on a protective basis as the verification process was incomplete.

100. On 4 October 2016 a decision letter denying input tax recovery in respect of 08/14 and 11/14 of £533,477.69 and £898,513.73 respectively. The suppliers were Euro Choice and Golden Harvest.

101. On 14 October 2016 an assessment was raised in respect of the period 11/14 in the sum of £898,513.73.

102. Horizon did not appeal these decisions.

103. As can be seen from Officer Cole's witness statement dated 13 September 2017, the documentation shows that Horizon had entered into twenty-one transactions with Elbrook between 1 April 2014 and 14 May 2014. 15 of the transactions concerned coke and diet coke, one concerned Lucozade and the remaining five concerned mixed soft drinks. In respect of each transaction there was a corresponding transaction on the same day between Horizon and Euro Choice pursuant to which Horizon bought identical goods, save for one transaction when there is a single day separating the date of the invoice delivered by Euro Choice and the invoice delivered by Horizon. The prices paid on each leg are remarkably stable. We note that the price paid for coke and diet coke by Elbrook from Horizon was £19,188 on 12 occasions and £18,218 on three occasions, and the prices paid by Horizon from Euro Choice were correspondingly constant, with the price for coke and diet coke being £18,876 on 12 occasions and £18,906.25 on the remaining three occasions. The same pattern of pricing can be seen in the invoices recording sales of soft drinks.

104. Of the 335 transactions undertaken, Horizon were engaged with the last 21 transactions. HMRC have numbered each transaction in sequence and the Horizon transactions are numbered 315 to 335. The fraudulent Defaulting Trader, UK Beer & Wines Ltd, was the ultimate supplier in respect of deals 315 to 319. Logical Retail was the Defaulting Trader in respect of transactions 320 to 335. Gujar Ltd and Euro Choice were the Buffer Traders in all 21 transactions. Gujar Ltd, Euro Choice and Horizon were prosecuted as part of the criminal case involving the OCG.

105. The invoices issued by all parties in each chain were issued on the same day, save for one chain where the invoices were issued two days apart.

106. From the documentation HMRC recovered it can be seen that the originating supplier (i.e. the Defaulting Trader) in each transaction obtained no mark up, every other party received a mark-up of 10p per unit save in one instance when the mark-up was 11p.

107. The lack of mark-up for the originating supplier, who is said to have sourced the goods to be sold, is in our view uncommercial. We note that Mr Jayesh Shah, a director of Horizon, was convicted of cheating the public revenue and of conspiring to enter into/being concerned in the acquisition/retention/use/or control of criminal property and was sentenced on 24 May 2019 to 7 years and six months in prison.

DZ

108. DZ was incorporated on 10 May 2011. Its business was stated at Companies House to be “*wholesale of fruit and vegetable juices, mineral water and soft drinks.*”

109. Dashnor Zylfo (“**Mr Zylfo**”), the sole director of DZ, was appointed on 10 May 2011.

110. DZ applied for a VAT registration number on 26 May 2011 to conduct the business mentioned above. Form VAT1 records the estimated turnover in the next 12 months was £500. The principal place of business at that date was 81 Reston’s Crescent, London, SE9 2JD.

111. The registered address of DZ changed three times. By 2014 it was at 5 Assembly Passage, London, E1 4UT which DZ shared with a freight agency.

112. DZ were made aware of the problem of missing trader fraud in two visits by HMRC in January 2012 and September 2013.

113. DZ were subject to close monitoring by HMRC because the transactions DZ entered into with Elbrook were part of chains of transactions that commenced with tax losses. HMRC visited the DZ offices frequently. The following information was obtained by HMRC on those visits: DZ began working with Elbrook as a result of Mr Zylfo simply walking into Elbrook’s offices without any introduction where he met a person named Bikal. Mr Zylfo agreed some soft drinks sales to Elbrook on terms that his suppliers were to deliver direct to Elbrook and bear the cost of insurance and transport. These costs were not however reflected in the prices in the invoices.

114. On 19 May 2014 officers gave Mr Zylfo Notice 726 and the leaflet, “*How to spot a missing trader fraud*”. Mr Zylfo agreed to provide all paperwork for all transactions DZ entered into on a monthly basis.

115. DZ had entered into a transaction to buy soft drinks with Tariq Traders in December 2013 and a tax loss had ensued as a result of Tariq’s failure to pay VAT to HMRC. Officers visited DZ in August 2014. Mr Zylfo said he knew the directors of Tariq but the female director of Tariq had been reluctant to provide a copy of her passport. Mr Zylfo said that the soft drinks he bought from Tariq were transported directly to Elbrook and the cost of transport and insurance was Tariq’s cost. Officers informed DZ of the tax loss as a result of the transaction with Tariq and sent a tax loss letter concerning Tariq to DZ after the visit.

116. DZ had not supplied the monthly spreadsheets of transactions as required under the monitoring project for July and August 2014. HMRC made a visit to discuss the failure on 16 September 2014 and delivered another tax loss letter. Mr Zylfo said the failure to supply the spreadsheets was due to him being on a business trip to Turkey to secure mineral water supplies.

117. HMRC made a further visit on 29 October 2014 as DZ had failed to provide the August spreadsheet of transactions. Officers discussed the importance of the spreadsheets, doing Due diligence (“**DD**”) and served DZ with another tax loss letter.

118. In January 2015 there was a further meeting as Mr Zylfo had informed HMRC that he had changed the nature of DZ's business because of being caught up in fraudulent transaction chains. Instead of wholesale, DZ was then focussing on retail of soft drinks and water to local shops and restaurants. He was using a warehouse and van owned by the landlord of the warehouse and he employed the director of the landlord in the business. The monthly monitoring continued which Mr Zylfo found onerous.

119. On a visit in April 2015 Mr Zylfo lamented the loss of profitability in the retail business compared with the wholesale business.

120. On a visit on 24 June 2015 Mr Zylfo said he was finding the retail business tedious, and the returns were poor compared to wholesale. He informed the officer he had received wrong advice while doing wholesale business and he put his hands up for being caught up in the tax loss chains.

121. On a visit in July 2015 officers requested information and documents relating to the wholesale business previously conducted by DZ. Mr Zylfo was worried and said he hoped the enquiry was nothing to do with him as he is now in the retail sector. He was informed HMRC were investigating transactions where tax losses had ensued.

122. HMRC requested more documents on a visit in August 2015. Again, Mr Zylfo expressed concern. He recognised he had been badly advised when he operated the wholesale business.

123. Officers collected more documents and obtained information about DZ's accountants on a visit in September 2015.

124. In November 2015 officers requested more data about a number of suppliers including Bestway Cash & Carry, Chetans Cash & Carry, Josh Suppliers Ltd and Amish Wholesalers.

125. In a further visit in December 2015 Mr Zylfo provided more records and information on a new supplier Ozdil Ltd and confirmed he had no desire to return to back-to-back dealing and that he had learned his lesson.

126. More records were provided to officers on the visit in February 2016 during which Mr Zylfo asked for a new VAT registration number for DZ Cash & Carry Limited. HMRC asked for further information about what was to happen to DZ's business. This was not provided by the date set and so the application for the new registration number was refused.

127. Further visits occurred in March 2016 when the refusal to issue a New VAT number was discussed. DZ sought voluntary deregistration on 1 May 2016.

128. In April 2016 HMRC issued a letter denying DZ input tax recovery for the period 04/14. The officer reached the conclusion to deny input tax because the officer considered the transactions were connected to fraudulent evasion of tax and the officer considered DX knew or ought to have known they were so connected because:

- (1) All the purchases by DZ were from purported established UK traders. But the companies supplying DZ were all deregistered within a very short period of the transactions occurring. The suppliers to the suppliers were either hijacked or proven defaulters.
- (2) Most of the goods were delivered directly to Elbrook. DZ never saw most of the goods. One of the two Sparrowhawk transactions with DZ, the invoice showed Sparrowhawk delivering goods directly to Elbrook.
- (3) The goods in the Sparrowhawk chain were purchased from a residential terraced house on a residential housing estate in Hackney. There was no evidence of warehouse facilities.

129. HMRC withdrew the above-mentioned letter for technical reasons later after a review was requested.

130. The following suppliers to DZ were deregistered or missing traders:

| Supplier | Date | Deregistered "D"/ Missing Trader "MT" |
|----------------------------|----------|---------------------------------------|
| Tariq | 5/3/14 | D |
| Elegant Connections LTD | 26/11/13 | D |
| SLF Trading Ltd | 12/4/14 | D |
| Sparrowhawk | 1/6/14 | D |
| Universal Distribution Ltd | | MT |

131. DZ were party to 4 transactions involving sales to Elbrook which are the subject of this appeal:

| | Original Supplier and date of supply | Supplier to DZ and date of supply to DZ | DZ to Elbrook and date of supply | Goods | VAT |
|---|--------------------------------------|---|----------------------------------|-------------------|----------|
| 1 | | Innocent Wolesale 2/4/13 | 2/4/13 | coke | 3,542.40 |
| 2 | Marjot 27/11/13 | SLF Trading 5/12/13 | Invoice dated 3/12/13 | coke/diet coke | 3,283.20 |
| 3 | TPPTB Smithers Rapira Ltd | Tariq 12/2/14 | 12/2/14 | coke | 3,484.80 |
| 4 | | Sparrowhawk 21/3/14 and 31/3/14 | 1/4/14 | coke/diet coke | 3,484.80 |

Sparrowhawk

132. As mentioned above, Elbrook accepted that each of the following traders fraudulently defaulted in its obligation to account to HMRC for the VAT on supplies shown in VAT returns filed by it resulting in a tax loss to HMRC: Alexis Ltd, Arete Systems Ltd, Ashneet Ltd, Blueray Enterprises Ltd, Euro Choice, Europa Cash & Carry Ltd, Gujarr Ltd, Hobbs Close Ltd, Innocent Wholesale Ltd, Logical Retail Ltd, Marjot Ltd, Mr Cash & Carry Ltd, Saad Victoria Food & Wine Ltd, Sea Inn Foods Ltd, TPPTB Smithers Rapra Ltd, UK Beer & Wine Ltd, and Universe Drinks Ltd.

133. Elbrook did not accept that Sparrowhawk had failed to account for VAT owed to HMRC creating a tax loss to HMRC.

134. Sparrowhawk was party to transaction chain 314 involving Sparrowhawk, DZ and Elbrook. The transaction chain concerned the sale of coke and diet coke with output tax due of £3,484.00 in the period 04/14.

135. Sparrowhawk was incorporated on 10 December 2013 at a residential terraced house in Hackney. Its director was Akkas Ali whose previous work experience was as a decorator in the construction industry. The registered office and principal place of business was at the residential terraced house. Sparrowhawk was registered for VAT on 16 January 2014 to trade

as a wholesaler without any particular specialism in the sector. In the VAT registration application Mr Ali said he would be distributing confectionery and cold beverages to other retail stores buying from a supplier, adding commission, and delivering the goods himself to customers. HMRC visited the registered office on two occasions because it had not filed its first VAT return on time. The first was on 31 May 2014. Mr Ali was not present. His brother who was present said he had not heard of Sparrowhawk but thought it may be connected to Mr Ali but he did not have his brother's telephone number to enable the officer to check it. The second was an unannounced visit on 18 September 2014 by Officer King and one other, after Officer Ginn had informed Officer King that Sparrowhawk was a Defaulter Trader involved with Elbrook. An elderly woman was at the premises on that occasion. She understood little English but indicated that Mr Ali would be back at 1pm. Officer King asked that Mr Ali call HMRC. No call was received.

136. Sparrowhawk did not file a return for the quarter on time. On 29 September 2014 HMRC assessed Sparrowhawk for £3,484 in respect of the goods sold to DZ and on sold to Elbrook. HMRC considered a tax loss had arisen.

137. Sparrowhawk filed a VAT return on 24 October 2014 showing total sales of £1,387,930 and total purchases of £1,387,442 and £97.77 VAT due. HMRC received £97.00 from Sparrowhawk. HMRC has not been able to verify whether transaction 314 was included in the VAT return filed late. Officer King considered Sparrowhawk had filed the return overstating the input tax to prevent HMRC from collecting VAT. Officer King considered that Sparrowhawk was a defaulting trader having regard to the features of the trading pattern namely:

- (1) In the 104 days that Sparrowhawk traded it achieved sales of £1,387,144, some £13,340 sales per day which Officer King thought was an unrealistic number for a new trader.
- (2) The invoice to DZ was numbered 1009 which would have meant that in 104 days 9.7 invoices would have been issued daily.
- (3) As there has been no contact between HMRC and Sparrowhawk the returns etc cannot be validated.
- (4) The VAT registration was cancelled because of Sparrowhawk's failure to contact HMRC. But Sparrowhawk did not make contact to have the VAT registration reinstated or at all.
- (5) The principal place of business was a residential terraced property on a small housing estate which would be inadequate for a business with such a high turnover.
- (6) Sparrowhawk was dissolved on 4 August 2015.

Due diligence and problems in the supply chain

138. On 26 September 2007 HMRC sent a letter to Elbrook to raise awareness of MTIC fraud. Mr Khalid could not recall if he had read the letter but acknowledged that had he done so he would have been aware of MTIC fraud. The letter urged Elbrook to undertake due diligence in respect of suppliers and to contact HMRC to verify VAT numbers. It reminds Elbrook that it is Elbrook's responsibility to identify its suppliers. The letter also enclosed Notice 726 which discusses MTIC concerning computers and mobile phones and explains that a trader can become jointly and severally liable for missing VAT if there is a failure to undertake due diligence ("DD"). Section 8 of the notice describes certain DD tasks that should be undertaken:

“(1) To consider the legitimacy of customers and suppliers such as what is the supplier's history in the trade, are there normal commercial arrangements in place for

financing the goods, are the goods adequately insured, what recourse is there if the goods are damaged.

(2) To ensure commercial viability of the transaction, i.e. is there a market for the goods, is it commercially viable for the price to increase within the short duration of the supply chain, have normal commercial practices been adopted in negotiating prices, is there a commercial reason for payments to third parties.

(3) Undertaking commercial checks to ensure the goods are as specified and in good condition and have they been previously supplied to the trader.

(4) Examples of information gathered by existing businesses are set out and include, introduction letters, trade and credit references, checking VAT numbers, insisting on contact with a senior officer and making a visit to the supplier's premises. It recommends this documentation be retained."

139. Mr Khalid in his witness statement said Elbrook had followed all HMRC's recommendations in relation to DD but in oral evidence he said he meant all oral guidance given by officers. He accepted that the suggested DD tasks identified in the leaflet were carried out by the majority of businesses but suggested that he had many meetings with HMRC's Stratford office and implied he was relying on those meetings to bless his DD or obviate the need for him to do DD.

140. HMRC sent a letter to Elbrook on 25 May 2012 indicating MTIC was still an issue and enclosing a link to Notice 726 and the leaflet "***How to spot MTIC fraud***". Mr Khalid recalls reading the letter but not the leaflet.

141. The leaflet "***How to spot MTIC fraud***" sets out a list of characteristics for traders to look out for and be suspicious if you are dealing with companies that exhibit these characteristics. The list included:

- (1) Newly established companies with no trading history.
- (2) Contacts have poor knowledge of the business.
- (3) Unsolicited approaches from suppliers offering high value/volume deals for no apparent risk.
- (4) Repeated deals at low prices and consistent profit.
- (5) Entities trading from residential premises or short leases of serviced offices.

142. Mr Khalid could not recall having received the leaflet or having read it during the trading period. He acknowledged in oral evidence however that he ought to have been looking out for newly incorporated traders, individuals with little or no knowledge of the trade, and repeated deals at low or consistent prices and entities trading from residential premises. He also acknowledged that he would have been concerned about the provenance of the goods, that the goods delivered were as described and about the background suppliers.

143. It is clear from HMRC notes of a meeting on 9 April 2014 that Mr Khalid knew about MTIC fraud in 2009/10 and had read Notice 726.

144. The DD that Elbrook undertook in relation to each of Golden Harvest, DZ and Horizon was as follows:

- (1) Just as Horizon had engaged DDE to undertake DD on its suppliers, DDE was instructed by Elbrook to provide DD on Golden Harvest. Two reports were produced by DDE for Elbrook on Golden Harvest.

(i) The first was dated 25 September 2012 which is over 6 months after Elbrook had begun trading with Golden Harvest. The covering letter indicates that it was not possible to undertake a financial assessment because DDE were awaiting information from Golden Harvest. There is no indication that Elbrook followed up with DDE. The report refers to a site visit which is dated the day after the date of the report. The site visit report has not been produced. There are handwritten notes indicating missing items but no indication of follow up. The report identifies that there is a single director and that the company has an estimated turnover of £30m. There is no note to indicate that this was a potential problem. There is no evidence that references were taken up. Mr Khalid has not provided any notes of his review of the report prepared by DDE. There is also a document dated 16 February 2012 which suggests a site visit was made to Golden Harvest and the director was seen but the document is neither signed nor dated. Mr Mark Curley of DDE signed and dated the report on 26 September 2012 to denote the vetting was completed.

(ii) The second DDE report was sent to Elbrook with a letter dated 5 August 2013. A handwritten note stapled to the report says that the business and personal update was missing. Included in the report was a report review form to enable Elbrook to note any points that require action and to enable Elbrook to sign and date the document. The report review form is blank.

(2) The only DD produced for DZ was an email exchange of 20 November and 3 December 2014 initiated by Elbrook asking DZ to send DD as soon as possible. The transactions with DZ were between April 2013 and April 2014. The request postdates the last transaction with DZ by more than 6 months.

(3) No DD was produced for Horizon.

145. Elbrook produced DD documents in the middle of the hearing. These documents were apparently discovered at 107 Bond Road premises by Mr Khalid months after the sale of the cash & carry business to a third party during which period he still had access to the premises. The documents included DDE reports on three other suppliers/customers, Apex, Pivotal and Maryam. The reports had handwritten notes on them in blue and red. The handwriting was Mr Khalid's. Mr Khalid made notes raising concern about newly incorporated companies, individuals with little relevant background, inconsistent replies to questions concerning compliance and whether the trades will be in cash. When questioned in cross examination on the red flags raised by him on the DD reports and review forms, Mr Khalid found excuses to explain away the red flags he had raised, including that the supplier may have made a mistake in completing the form. He had no explanation as to why the directors of two new and allegedly independent suppliers should have had the same mobile phone number. He failed to see it was unlikely that a single director in a newly incorporated company whose personal bank account has a tiny credit balance would be able to fund large wholesale transactions. He also failed to notice that another director of such a newly incorporated company was in receipt of jobseeker's allowance. He said he was only relying on those bank statements to verify the address of the individual. Notwithstanding his own red flags Mr Khalid accepted these new suppliers/customers and his staff were enabled to purchase or sell goods from them.

146. The director of Maryam (the former customer of Elbrook) was the sole director of Myer Limited which company had been deregistered and had caused a tax loss to HMRC. Elbrook was aware of the fate of Myer as it had received the relevant deregistration and tax loss letters from HMRC. Maryam had received the business of Myer. Notwithstanding these facts Maryam

became a customer of Elbrook, whereas Myer had been a supplier. The transactions undertaken with Maryam were in bond alcohol sales in France which Maryam on-sold to Hassalt a cash and carry based in France. The trades generated high volumes of Sterling currency that was couriered to the UK and deposited in Elbrook's bank account at various branches around the UK because it was said French cash & carry companies receiving sterling could not deposit the cash in a bank in France. These trades were made notwithstanding Elbrook knew that cash was a red flag, that alcohol trades are high risk and that the sole director of Myer was now the sole director of Maryam.

147. HMRC sent many letters informing Elbrook that the VAT registration of suppliers had been revoked. From 11 June 2010 to 24 February 2011 HMRC sent seven such letters to Elbrook. Each letter indicated that HMRC had revoked a supplier's VAT registration number from a particular date and all input tax claims on supplies after that date will be denied.

148. HMRC also sent tax loss letters to Elbrook informing Elbrook that HMRC had suffered loss of VAT because of suppliers whose VAT registrations had been revoked.

149. Mr Khalid asserted in cross examination that receipt of a tax loss letter would cause Elbrook to augment the DD process. But we note that receipt of a tax loss letter did not cause Mr Khalid verify his suppliers or to consider asking his suppliers to verify their supply chains.

150. Notwithstanding the link between deregistration and tax loss, Mr Khalid denied in cross examination that there was a connection between VAT deregistration and tax loss unless, in addition, HMRC issued a VAT assessment on the company that had been deregistered. Mr Khalid said that was so because the deregistration may have been voluntary. Mr Khalid said he would have called the supplier to see what was going on following receipt of a tax loss letter and he would stop trading with the supplier but only until the issue with HMRC and the supplier was resolved. There was no documentary evidence of any such contact with these suppliers. We consider Mr Khalid's reaction was irrational.

151. Mr Khalid did accept that in mid-2011, when Elbrook had received four tax loss letters in a month concerning transactions entered by Elbrook worth £2m that had resulted in a tax loss to HMRC of £310,000, that there were serious problems with Elbrook's supply chains.

152. Notwithstanding that Mr Khalid was wary of companies run by single directors, he continued to deal with Mr Aris, the sole director of Myer Ltd, after Elbrook had received a tax loss letter from HMRC in May 2011 in respect of Myer Ltd, and when Mr Aris moved the business to Maryam Limited, Elbrook accepted Maryam Limited as a customer. We consider Mr Khalid's behaviour was irrational.

153. HMRC sent further letters to Elbrook warning of continuing issues in the wholesale commodities business:

- (1) on 25 May 2012 warning of MTIC VAT fraud in wholesale commodities,
- (2) on 28 May 2012,
- (3) on 7 February 2014 warning of fraud on certain platforms.

Contractual terms - purchase prices of soft drinks

154. The soft drinks with which this appeal is concerned were manufactured at the relevant time either by Coca Cola or GSK.

155. Elbrook was a member of the Today Group, a collective of European Cash and Carry companies that buys goods directly from manufacturers to enable them to compete in price terms with large supermarket chains such as Tesco.

156. Today Group had accounts with GSK and Coca Cola.

157. Discounts offered by Coca Cola to the Today Group members included discounts to the prices which were shown on the invoices “on invoice discounts” and “override discounts” which are determined by volume of goods purchased and the discount is paid by Coca Cola at the end of the trading period to the Today Group and it is then distributed by the Today group to the members according to the volume of goods purchased.

158. Notwithstanding the advantages of being a member of the Today Group Elbrook bought goods from Golden Harvest, Horizon and DZ.

Coca Cola’s products

159. HMRC obtained data from Coca Cola about its soft drinks' sales prices and discounts available to Elbrook as a member of the Today Group. The data for 2012 was more detailed than for other years. HMRC analysed the data it received from Coca cola and that extracted from the SAGE accounting system provided by Elbrook. HMRC assembled the results about the prices Elbrook bought goods from Golden Harvest, Horizon and DZ in annex 3 to the HMRC’s submissions (“*Annex 3*”) and set out in annex 5 (“*Annex 5*”) a comparison of the prices at which goods were offered to Elbrook by Coca Cola in 2012 compared to the prices at which Elbrook purchased goods from Golden Harvest in 112 of the transactions as shown in Annex 5 to HMRC’s submissions.

160. The data shows the prices paid to Golden Harvest and Horizon are remarkably constant over the 30-month period in question compared with the list prices of the products sold by Coca Cola which fluctuated constantly and not insignificantly upwards and downwards from month to month. (There are only 4 transactions with DZ over a shorter period of time, the prices per case were £6.35, £5.99 and £6.25 and £6.25 so no trend can be detected.)

161. The also data shows that the prices at which Elbrook bought goods manufactured by Coca Cola from Golden Harvest and Horizon in 2012 in respect of 6 of the 8 products purchased (coke and diet coke were the exceptions), were higher from Golden Harvest and Horizon by between 65p and 95p per case of 24 cans. This makes no commercial sense. If margins are tight in a cash & carry as Elbrook wish us to believe, why would Elbrook buy these goods at inflated prices from Golden Harvest and Horizon when they are available more cheaply from Coca Cola?

162. Coke and diet coke represented 59% of all purchases of soft drinks by Elbrook in 2012. The data made available by Coca Cola for 2012 about the discounts that Elbrook were entitled to as a member of the Today Group shows that when the “on invoice” discounts were included the price payable to Coca Cola for coke and diet coke by Elbrook would have been less then Elbrook had paid to Golden Harvest. Annex 5 shows that Elbrook bought coke directly from Coca Cola on only 4 separate occasions in 2012: on 5 and 6 March 2012 when it paid £6.42 and £6.36 per case of 24 cans, and on 23 and 24 April 2012 when Elbrook paid £5.95 per case. Yet in 2012 Elbrook bought coke from Golden Harvest on 97 separate occasions, on one occasion they paid £5.95 per case but for the remaining 96 occasions they paid £5.99, £6.15 and £6.17 per case. This makes no commercial sense. Given the tight margins one would expect Elbrook to have selected the cheapest supplier on every occasion.

163. In cross examination Mr Khalid suggested for the first time that the reason Elbrook had purchased goods from Golden Harvest and Horizon was due to price. Mr West had said in cross examination that it was possible to buy more cheaply than the prices being offered by the manufacturers owing to loss leaders etc. We accept loss leaders occasionally result in prices lower than the manufacturer’s price but given the relative lack of movement in the prices at which goods were purchased from Golden Harvest and Horizon and the constant movement in prices of goods sold by Coca Cola we consider that if the prices offered by Golden Harvest and Horizon had been consistently less than that being offered by the manufacturers would have

been too good to be true and would have caused Elbrook to look more closely at the supply chain. We also consider that the prices being offered were consistently above Coca Cola prices there would be no reason to purchase the goods from Golden Harvest, Horizon or DZ at all.

164. Mr Khalid did not produce any evidence of the discounts available and the prices Elbrook were entitled to purchase goods from Coca Cola. He also questioned HMRC's use of the data extracted from Elbrook's records but did not produce any expert able to analyse the data. In cross examination Mr Khalid queried the value of the discounts in the data used by HMRC and whether they included the override discounts that were payable only at the end of a trading period which he said involved tying up capital. He did not produce any evidence of the cost to Elbrook of tying up capital and therefore the impact on the prices, which is a function of interest rates. We note that if the prices being offered by Coca Cola are lower than those being offered by third parties with the on-invoice discounts alone it makes no sense to pay the third parties at all. But even if the prices were only lower when the override discount is received, it would still be more advantageous to buy from Coca Cola. The higher price can never be recovered.

GSK products

165. HMRC did not have the same data for GSK products. But GSK confirmed that it is unlikely that they had been prevented from providing product to Elbrook due to lack of supply.

166. Mr West was an account manager of GSK for the Today Group which had 100 members including Elbrook. Mr West was not therefore directly involved with sales to Elbrook. He would liaise with the sales manager to whom the sales representatives reported. Mr West's role was to increase the volume of sales to the Today Group. Mr West sought to visit each member two or three times a year and ensure they received the benefit of periodic promotions and support for promotions being offered by the member. On visits to Elbrook, Mr West met both Khalid brothers as the meetings were pre-arranged.

167. The Today Group was entitled to 2% "over-rider" discount of total sales from GSK and was rebated periodically, at the end of a trading period. The rebates received by the Today Group were distributed to individual members according to the volumes of goods purchased by the member. A dedicated sales representative could also award discounts, but they were not cash discounts, they could take the form of free product or product to support an event.

168. Mr West, who gave evidence of fact, and not expert evidence, to the Tribunal, put forward many reasons why a person could buy soft drinks more cheaply from a third party than from a manufacturer, such as a loss leader offered by supermarket chains or other Cash & Carry companies, and why there may be a grey market but did not give any evidence as to what actually happened in the 335 transactions we are considering. His evidence was not therefore helpful. We note however that he said that there were no certainties as to what might happen to the price at which goods could be on-sold given the strategies that players in the market may be pursuing. We infer from this lack of certainty, that the prices in any grey market would likely fluctuate and were unlikely to follow a flatline or straight trajectory over the 30-month period we are concerned with.

Other contractual terms

169. Elbrook had no written contracts with any of Golden Harvest, Horizon or DZ or any emails or texts or faxes recording any negotiation or the final terms of the transactions or the transactions themselves.

170. The only contractual term, apart from the sales price and the description of the goods recorded on invoices issued by companies in the chains was a retention of title clause. Title

was retained by the seller until payment was received. However, Elbrook mainly paid long after the date of delivery.

171. In cross examination Mr Khalid sought to explain away Elbrook's non-compliance with the only recorded commercial term by saying that Elbrook had the benefit of credit advanced to it by Golden Harvest. There was no credit agreement, no terms recorded in emails or texts or faxes. There was no record in the DD report provided by DDE of any credit check having been carried out. The amount of the credit on occasion amounted to £200,000. It is inconceivable to us that the terms of such an arrangement would not be recorded. Mr Khalid's explanation in cross examination of the credit terms, in particular the period for which credit was available, was inconsistent and unconvincing.

172. There was no record of any agreement on the return of damaged goods. Invoices obtained from Elbrook showed that of 170 purchases from Golden Harvest in 2013, 105 were marked as damaged as shown in Annex 2 to HMRC's submissions. Mr Khalid in cross examination said that it was possible that only one can of a large consignment would be damaged rather than the entire case being damaged, and the warehouse staff would simply repack the undamaged cans. If that was the case, it seems to us that the handwritten note on the invoices was inadequate to enable Elbrook to recover the actual loss from Golden Harvest.

Lack of supply

173. Elbrook's position, as set out in Mr Khalid's witness statement made in 2017, was that Elbrook bought directly from Golden Harvest, Horizon and DZ rather than the manufacturers because of lack of supply.

174. Mr West reluctantly agreed that the purchase of Lucozade from persons other than the manufacturer, was unlikely to be due to lack of supply. Mr Khalid also appeared to alter his position in cross-examination in relation to Lucozade.

175. Elbrook produced no evidence to show there was a lack of supply of soft drinks from Coca Cola, notwithstanding that Mr Khalid had said in correspondence in 2017 that he had written evidence from Coca Cola as to why they would buy from third parties rather than Coca Cola and would produce it in any Tribunal hearing. In cross examination Mr Khalid said that Elbrook was unable to get data from Coca Cola because their dedicated sales representative had left Coca Cola. Mr Khalid also said he had seen information on Google about lack of supplies in 2012 but did not produce the searches. We found this unconvincing.

176. Mr West conjectured that in 2012 there may have been a shortage of soft drinks owing to the Queen's Diamond Jubilee and the London Olympic Games, as can happen when demand is high. But that would not explain why even more soft drinks were bought from third party suppliers in 2013 when there were no such events causing increased demand from GSK and Coca Cola.

177. Mr Khalid also thought the closure of roads during the Olympics would have affected Coca Cola's ability to deliver. The same road closures would have affected Golden Harvest and Horizon and so this is unconvincing.

178. HMRC had received information from Coca Cola that they had no records of any inability to supply product ordered by Elbrook. Elbrook said that orders finally placed may well have been fulfilled but that does not mean all requests resulted in firm orders. Given the pattern of purchases from Golden Harvest and Horizon as shown in Annex 5, it seems to us unlikely that that was the case.

Price

179. As mentioned above, in cross-examination Mr Khalid said for the first time since the dispute began that the reason he bought from Golden Harvest, Horizon and DZ, rather than directly from the manufacturers, was price.

(1) This would make little sense as the whole point of being part of the Today Group was to enable Elbrook to compete on price with the supermarket chains. Mr Khalid and Mr West accepted that was the purpose of being a member of the Today Group.

(2) Coca Cola had produced prices at which coke was offered to the Today Group in 2012 and all discounts available to it. HMRC took data provided by Elbrook from SAGE identified the product codes and extracted all the prices at which Elbrook bought coke and diet coke. HMRC produced a table of results at Annex 5. The result was that the price paid by Elbrook to Golden Harvest for all but two products they bought from Coca Cola was greater than the price it would have paid to Coca Cola. In the case of the purchase of coke and diet coke there were two occasions on which Elbrook bought from Coca Cola, in early March 2012, when the price at which Elbrook had bought coke from Golden Harvest was 7p lower per case than the fully discounted price available to Elbrook as a member of the Today Group. Given the tight margins Mr Khalid said Elbrook operated we consider it makes no commercial sense for Elbrook to have bought from Golden Harvest in 2012 rather than Coca Cola.

(3) Mr Khalid said that the way override discounts are offered and paid at the end of the trading period made it unattractive to buy from Coca Cola as Elbrook were tying up capital. This explanation had not been made by Elbrook before the hearing. As mentioned above, we find this makes little sense when the prices being offered by Coca Cola were in general lower than the prices paid by Elbrook to Golden Harvest.

180. We accept that it may be possible on occasion for products to be capable of being purchased at a price lower than that being offered by a manufacturer because of loss leaders being offered by traders. We consider it highly unlikely that that would be possible for all 335 transactions over a 30-month period.

181. We note that the prices offered by the manufacturers varied significantly upwards and downwards over the 30-month period. We find it difficult to believe that products could be acquired legitimately at prices that did not reflect to some extent that variation.

Coca Cola's inability to supply product

182. Elbrook provided no evidence of Coca Cola's inability to meet consumer demand. Coca Cola informed HMRC in writing that they had limited information available going back to 2012 but since 2015 they can confirm there were no instances of Coca Cola being unable to meet consumer demand save for the supply of mineral water for a short time due to plant issues. We consider it unlikely that there were regular product shortages which forced Elbrook to buy from other direct suppliers.

The profit shares of companies in the chains

183. HMRC prepared a spreadsheet (Annex 3 to HMRC's submissions) showing the 335 transactions, the suppliers in each chain and the price at which each member of the chain purchased and on-sold the soft drinks. HMRC refer to the difference in the two prices by a supplier in the chain as a mark-up. The mark ups on the goods as they passed down the chain hardly vary in the 30-month period under consideration. The mark-up charged by Golden

Harvest was between 2, 3 and 4p per case, the supplier to Golden Harvest secured mark ups of 3p per case. Elbrook secured 18p per case. We consider this allocation of mark-up is contrary to the risk and reward one would normally expect where the originator in the chain has secured an advantageous price for the goods by its own ingenuity or endeavours.

184. Elbrook's consistent 18p per case mark-up on goods bought from Golden Harvest in the 30-month period is highly suspicious and ought to have put Elbrook on notice as to the legitimacy of the supply.

185. One document obtained by HMRC surveillance team of the OCG was a spreadsheet. The "mark-up" on the price of the goods sold in the chain was referred to as commission.

Tracing the goods sold by Golden Harvest, Horizon and DZ to manufacturers

186. We note that HMRC found no evidence to trace the goods that were the subject of the 335 transactions back to the manufacturers.

Volume of stock purchased by Elbrook from Golden Harvest, Horizon and DZ

187. The data provided by Elbrook enabled HMRC to identify the volume of stock purchased by Elbrook in the 30-month period under consideration and to compare it with the data provided by Elbrook on sales. Purchases exceeded sales by 6.4 times, but the excess stock was not in Elbrook's warehouse. This caused Officer Ginn to have grave concerns as to whether the transactions had taken place. We share those concerns.

188. Mr Khalid said in cross examination that the data used by HMRC would be flawed because Elbrook often reallocate a product code used to buy goods from manufacturers to other products and so not all sales will be picked up in consequence HMRC's calculations will be inaccurate. We note that if that had occurred there would have been more transactions than those identified with greater volume discounts being available to the Today Group. However, as coke and diet coke were bought on a weekly basis it is unlikely that the codes for these products were reallocated. The reuse of codes does not undermine the modelling that HMRC undertook.

189. Coca Cola advised HMRC that they would have expected a Cash & Carry of Elbrook's size to have ordered 0.5m cases of soft drinks from them per year. The volumes purchased by Elbrook were:

- (1) 1/1/12 to 31/12/12, 19,173 cases from Coca Cola and 302,640 from Golden Harvest, Horizon and DZ
- (2) 1/1/13 to 31/12/13, 7,400 cases from Coca Cola and 423,311 cases from Golden Harvest, Horizon and DZ
- (3) 1/1/14 to 31/7/14, 7,435 cases from Coca Cola and 134,420 from Golden Harvest, Horizon and DZ.

Deregistration

190. Prior to 14 March 2014 when the Ablessio decision was handed down by the CJEU, it was difficult for HMRC officers to deregister a trader who was registered for VAT without a very protracted process because of the obvious and potentially devastating financial consequences for the trader.

HMRC's CASE

191. HMRC invited the Tribunal to dismiss the appeal against the denial of VAT input tax of £1,273,739.55 and find that it had established on the balance of probabilities that Elbrook knew that 335 of its transactions in the 30-month period were connected with fraud or ought to have

known that in the circumstances the only reasonable conclusion that could be drawn was that the transactions were connected with fraud.

192. In relation to Sparrowhawk, it was a supplier to DZ in respect of a single transaction in respect of which two invoices were issued. HMRC accepts that it is not in a position to say whether the two invoices were included in the late VAT return filed by Sparrowhawk, but the tax loss that HMRC say arose was caused by an inflated input tax claim. Sparrowhawk filed a VAT return showing a turnover of c.£1.4m and inputs of £1.396m, with a mere c£400 profit and a net VAT liability of £97. The overstatement of input VAT is the VAT fraud. Sparrowhawk also displayed all the characteristics of a company involved in fraudulent trading, such as a single director, purporting to operate from residential premises, no warehouse space, failure to communicate with HMRC resulting in suspension of its VAT registration after the first quarter which is never reinstated, turnover of over £1m in a single quarter from the commencement of business which is unknown in HMRC's observation of new businesses. A late return was only filed after HMRC has issued an assessment to recover VAT on supplies to Elbrook. The input tax claimed is out of line with the output tax in a commercially run operation. The company was dissolved the following year.

193. In relation to DZ, the Appellant accepts that the suppliers to DZ had been engaged in VAT fraud but does not accept that DZ was involved in an orchestrated VAT fraud. HMRC says that DZ knew that the transactions it was engaged in were connected with fraud as can be seen from the following:

- (1) Mr Zylfo, the sole director of DZ, was made aware of missing trader fraud at two HMRC visits in January 2012 and September 2013.
- (2) Mr Zylfo supplied soft drinks directly to Elbrook. He had simply walked into the Elbrook premises without introduction, met Mr Bikal an employee of Elbrook at the premises, and started selling soft drinks to Elbrook.
- (3) Mr Zylfo acknowledged that the soft drinks he sold wholesale were supplied directly to Elbrook and he never saw them. The insurance and transport costs were supposed to be borne by the supplier, but the invoices do not show that there is a fee for those services.
- (4) DZ's suppliers were SLF Trading, Tariq and Sparrowhawk. All of DZ's suppliers have been de-registered for VAT.
- (5) DZ received the leaflet "how to spot a missing trader fraud" on 19 May 2014 at a meeting with HMRC at which the importance of DD was discussed.
- (6) DZ received a tax loss letter dated 29 August 2014 concerning DZ's purchases in December 2013 from Tariq.
- (7) In September 2014 Officers urged DZ of the importance of doing DD.
- (8) Despite being required to produce monthly spreadsheets of deals done DZ failed to do so. A further tax loss letter was issued on 29 October 2014 and officers discussed with Mr Zylfo joint and several liability for lost VAT.
- (9) On 18 February 2015 Mr Zylfo informed officers on a visit that he was now only dealing retail because he regretted being caught up in tax loss chains.
- (10) Mr Zylfo was reluctant to provide information about wholesale deals and hoped HMRC's enquiries had nothing to do with DZ. He said he had learned his lesson and would never do wholesaling again.
- (11) HMRC issued a denial of input tax letter on 27 April 2016 because:

- (i) 84 of DZ's transactions were traced to three defaulting suppliers Sparrowhawk, Universal and Tariq.
- (ii) DZ had known the risk of VAT fraud since 2012 but had undertaken no DD.
- (iii) The transactions were back-to-back.
- (iv) DZ did not take physical delivery of the goods.
- (v) There was no commercial reason for DZ to be in the chain of transactions as DZ added no commercial value and the trades were too good to be true.

(12) All of DZs wholesale suppliers were either missing or deregistered traders which is beyond coincidence. That DZ entered into 84 transactions with three suppliers that caused fraudulent tax losses in three months is beyond coincidence. That Mr Zylfo said to officers he "put his hands up" to wholesale back-to-back transactions and was reluctant to provide documentation indicates Mr Zylfo knew what the trades involved. No DD could have been done as Mr Zylfo would have realised two suppliers were operating from residential premises and SLF was said to carry on a hair and beauty products business.

(13) All of the above indicates that DZ were willing participants in an overall scheme to defraud HMRC.

194. As to whether Elbrook knew or should have known they were participating in transactions connected to an orchestrated scheme to defraud HMRC, HMRC noted that cases such as these there is rarely a single piece of evidence such as a smoking gun or a confession. HMRC invited the tribunal to consider all the circumstances of the transactions and not to compartmentalise the individual strands of evidence. When viewed together, HMRC assert that the individual pieces of evidence are, like the individual strands in a rope which together form a rope, when looked at together are as powerful as direct evidence.

195. HMRC considered there are ten strands of evidence:

(1) **The scale of the tax losses.** HMRC say that following Mobilx the Tribunal is entitled to conclude that 335 transactions in just under 30 months cannot be explained away by innocent coincidence. It is beyond coincidence that three different suppliers involved Elbrook in fraudulent transactions in every VAT quarter period for 30 months. The most likely answer to the question why the suppliers were drawn to Elbrook was because Elbrook knew about the fraud. A few transactions over the period could be misfortune but 335 could not.

(2) **The existence of an orchestrated scheme to defraud HMRC.** The following factors demonstrate the scheme: the scale of the losses across three different suppliers, the defaulters are continually deregistered and replaced, the transactions seem to have functioned on trust, the defaulters knew the location and identity of the end customer- a commercially unrealistic proposition, the Buffer Traders and Defaulting Traders and the transactions themselves were riddled with the indicia of contrived trading. In light of this, there are three possibilities in relation to Elbrook's state of knowledge:

- (i) Elbrook was involved because it knew the transactions were connected to fraud,

(ii) Elbrook ignored the obvious and should have known the transactions were connected with fraud.

(iii) Elbrook was an innocent dupe which would suggest an external mechanism to control Elbrook's purchasing decisions.

HMRC consider that in the abstract it is possible for an innocent legitimate trader to be caught up in such a scheme. But in this case, we are not dealing with abstract notions we are dealing with these fraudulent traders and whether these organised criminals involved an innocent legitimate trader.

HMRC consider that (iii) should be disregarded as Mr Khalid was by his own admission no-one's fool. He was in charge of Elbrook's purchasing decisions. No one was telling him what to buy and no one could take advantage of him.

HMRC consider that (i) is more likely than not. The fraudsters would not involve someone who did not know of the fraud because of the risk of whistle-blowing that would inevitably lead to prosecution of those in the chain. Golden Harvest and Horizon dealt directly with Elbrook. They trusted Elbrook not to blow the whistle. HMRC consider the Tribunal can safely conclude that it was more likely than not that Elbrook knew what the transactions were about.

HMRC do not accept as Elbrook contends that the length of the chain should be disregarded if the Tribunal concludes there is no actual knowledge. In this case Mr Khalid was aware of the length of chain with Golden Harvest as Mr Khalid said in cross-examination that Golden Harvest was buying the goods from another cash & carry. So Mr Khalid knew there were at least three wholesalers in the chain.

HMRC say that Elbrook's reply to the question why Elbrook was chosen as the counter party to the 335 transactions, namely because Elbrook was a cash & carry and sold the soft drinks in question, is inadequate. The question required consideration of why these terms, these prices, these parties, and these suppliers. HMRC say Elbrook was chosen because Elbrook knew.

HMRC say that the warnings given to Elbrook in 2011 about fraud in the wholesale commodities sector and in its own supply chain, and Elbrook's lack of reaction to them, supports an inference of knowledge such that (ii) is satisfied. In this connection HMRC say two points should be considered: First the statements made by Mr Khalid in cross examination, that he had read leaflet 726, Elbrook knew about the DD checks that ought to have been made, understood their importance but considered it was for the protection of Elbrook and not HMRC. Second, Mr Khalid made inconsistent responses in cross examination about whether Elbrook would continue to trade with a supplier in respect of whom a tax loss letter had been received and his stated view that it would depend on whether an assessment in respect of the lost VAT had been received by the supplier, but did admit that there were serious problems in Elbrook's supply chain in 2011.

(3) **Elbrook's reaction to the warnings of alcohol diversion fraud.** Although not directly concerned with the transactions in these Kittel appeals, the DD evidence produced by Elbrook in the middle of the hearing of these appeals about three companies with whom Elbrook began trading at the same time as the transactions under appeal, is indicative of Elbrook's approach to DD at the time. The evidence concerned Mr Khalid's reaction to the warnings of alcohol diversion fraud and his lack of rigour in relation to the DD of Apex, Maryam and Pivotal that bore all the hallmarks of players in such a fraud and with whom Elbrook went on to do £60m of business for which cash was paid in France in Sterling, was couriered

daily to the UK to be banked because, improbably, Mr Khalid believed French cash & carries who take Sterling were unable to bank the cash in France. Mr Khalid chose to do business with these companies notwithstanding that:

- (i) Mr Khalid knew one of the indicators of possible fraud was large cash transactions.
- (ii) Mr Khalid commenced trade with Maryam, whose sole director was also the sole director of Myer Ltd which Mr Khalid knew had been deregistered and had caused HMRC a VAT loss.
- (iii) Further Maryam became a customer of Elbrook purchasing alcohol in bond in France and on sold to Hasselt. This HMRC says is an example of contrived trading that cannot be explained by ordinary commercial factors and Mr Khalid's insistence that it was ordinary commercial arrangement is a monumental piece of self-delusion.

HMRC say that Mr Khalid's approach to DD was a shambles at best, and at worst, mere window dressing. With over 10 years' experience in the business and awareness of high-risk sectors, it must have been apparent to Mr Khalid that Elbrook should not have been trading with any of Apex, Maryam or Pivotal.

(4) **Lack of cogent commercial explanation for purchasing from third parties instead of the manufacturers.** Elbrook say they have two reasons, the first was lack of supply from the manufacturers and the second was price. Mr West gave evidence for Elbrook on these two points. HMRC noted that Mr West, was not an expert witness and so must be regarded as a witness of fact but did not provide any evidence in respect of the transactions under review. HMRC suggested that the Tribunal should give little weight to his evidence.

(i) **Lack of Supply.** HMRC point out that Mr Khalid's first explanation for buying from the suppliers in this appeal was shortage of stock. Mr West reluctantly accepted in cross-examination that Elbrook's purchases of GSK products from Golden Harvest and Horizon could not be attributable to stock shortages. HMRC say that even Mr Khalid in cross examination appeared to row back from that explanation in relation to Elbrook's purchases of Lucozade from GSK. Further, HMRC say that Mr Khalid had provided no evidence from Coca Cola about them being unable to meet Elbrook's requirements. His explanation that the sales representative Elbrook used at Coca Cola had left the employment does not explain the absence of that evidence. Coca Cola had informed HMRC upon a written request sent to the tax function, that Coca Cola could not locate any occasion in 2012 where they could not provide Elbrook with the goods they had ordered and that it was rarely unable to meet demand. HMRC considered Mr Khalid's claim that Google searches (which Mr Khalid had not produced) contradict what Coca Cola had said and that HMRC had failed to contact the correct personnel in Coca Cola, were not tenable and were without evidential foundation. Inconsequence HMRC say Mr Khalid's assertion that one reason for purchasing goods from the third parties was lack of supply is wrong.

(ii) **Price** HMRC noted that Mr West did make statements in his witness statement about the benefits of being able to buy at competitive prices by being a member of the Today Group and recanted on them in cross examination. HMRC noted that Mr West provided various reasons why someone could sell at a lower price than the manufacturer, and HMRC

accepts that it can happen in most markets some of the time, but it is not an explanation of why Golden Harvest undercut Coca Cola in transactions 1 and 2 of 2012. HMRC say this is because the transactions were part of a fraud and not part of any grey market trading at all. HMRC point to the following items of evidence and argument:

(A) Mr Khalid said in his witness statement that the point of being in a buying group like the Today Group is to get the best prices. HMRC submit that Elbrook's actual membership of such a buying group makes it extraordinary that Elbrook chose to purchase huge volumes of goods from Golden Harvest, Horizon and DZ. Mr Khalid accepted in his evidence that he was not saying that for this thirty-month period Coca Cola had insufficient offers, discounts or overrides to make purchasing from them attractive.

(B) HMRC pointed out that Mr Khalid had not provided any calculations for the prices at which Elbrook purchased the goods from Coca Cola. HMRC's best calculations set out in Annex 5 to HMRC's opening submissions, based on data from Coca Cola, shows that Elbrook purchased from Golden Harvest time and again when it could have purchased more cheaply from Coca Cola. Mr Khalid's criticism that the calculations did not reflect all the discounts, from Coca Cola renders it even more inexplicable that Elbrook did not purchase from Coca Cola.

(C) Mr Khalid's explanation offered in cross examination that he purchased from the other suppliers to avoid tying up cash with the Today Group as discounts arrived after the end of the trading period, lacks credibility when the prices offered by Coca Cola were lower than those offered by Golden Harvest, and by virtue of the fact that the argument had not been previously advanced in the eight years it has taken to come to trial.

(D) HMRC say that Mr Khalid's other explanations about the 2012 purchases, the Queen's Diamond Jubilee, the Olympic Games and heatwave which increased demand and caused road closures, causing Elbrook to hit its purchasing limit with the Today Group, were not credible, not least, HMRC submit, because Elbrook purchased more Coke in 2013 than it did in 2012, and because despite the apparent road closures Elbrook claims that all the deliveries from Golden Harvest got through to it.

Mr Khalid had claimed in correspondence with HMRC to have written evidence from Coca Cola about suppliers purchasing at prices lower than those offered by the manufacturer, going as far as to say that this would be produced at the tribunal if necessary, and it never was. Mr Khalid's explanation that the absence of a sales rep was the reason for this, HMRC submit, was not credible. HMRC invite the Tribunal to reject pricing as Elbrook's second reason for buying from the suppliers in these transactions. Elbrook has not advanced any cogent reason for these third-party purchases made in large part at prices higher than the manufacturer could sell them, and indeed did sell them.

(5) Lack of ordinary commerciality in the transactions

HMRC consider that:

- (i) the lack of any record of any kind relating to the making of the contracts to purchase goods by Elbrook from Golden Harvest, Horizon and DZ,
- (ii) the lack of fluctuation in prices in the goods bought from Golden Harvest and Horizon indicates there was no negotiation between the parties,
- (iii) the lack of written terms of those contracts except for the retention of title clause which was included in the invoices but not adhered to by Elbrook on many occasions and rendered it pointless,
- (iv) the lack of any written record of terms of credit afforded to Elbrook, which on occasion amounted to £200,000, which Mr Khalid said in cross examination explained why the retention of title clause had in fact been adhered to,
- (v) the lack of consistent explanation by Mr Khalid of the terms of the credit in particular the period for which credit was given,
- (vi) the lack of credit checks on Golden Harvest in the DD and no financial report on Golden Harvest in DDE's report to support the provision of credit, and
- (vii) the lack of any record of the terms relating to the return of damaged goods or any evidence of Elbrook questioning the large number of instances on which damaged goods were provided by Golden Harvest,

is wholly uncommercial and when considered in view of the fact that the directors of each of Golden Harvest and Horizon were both criminals, is consistent with the transactions being connected with fraud.

(6) Lack of adequate Due Diligence on Suppliers

HMRC say that:

(i) In relation to Golden Harvest:

- (A) Mr Khalid did not provide any initial due diligence or supplier questionnaire,
- (B) the DDE report on Golden Harvest post-dated the first day of trade by some six months,
- (C) DDE could not produce a financial assessment on Golden Harvest,
- (D) the report dealt with the provision of alcohol when the contract was for soft drinks because in Mr Khalid's view DDE did not know what Golden Harvest would be doing,
- (E) the DDE report showed Golden Harvest trading from a 200 square foot serviced office, Mr Khalid thought it was storing 6,000 cases of soft drinks and Golden Harvest considered it did not need storage space because its suppliers delivered directly to its customers,
- (F) Golden Harvest was a one-man band with a turnover of £30m per annum,
- (G) no trade references were followed up, and

(H) the second DD report contained an erroneous declaration dealing as it did with the payment of excise duty. There is no excise duty on the sale of soft drinks.

(ii) **In relation to DZ:**

(A) Mr Khalid failed to provide any DD reports which he said were undertaken prior to trade commencing with DZ.

(B) the documents provided showed DZ existed, it was registered for VAT and it had not used a corporate credit card.

(C) there was no report by DDE and Mr Khalid accepted the documents did not provide any information about the bona fides of DZ.

(iii) **In relation to Horizon:**

(A) The DD report was first produced by Mr Khalid as an exhibit to his witness statement in 2017.

(B) Mr Khalid failed to produce a supplier questionnaire or any initial DD.

(C) The DDE report of Horizon was provided 4 months after trade had commenced and contained irrelevant material about alcohol. It stated its customers and suppliers arranged transportation of the goods which Mr Khalid said was incorrect. It described Elbrook as a supplier to Horizon and Mr Khalid explained in cross examination it should have been a reference to “Drinks Cash & Carry Ltd” but as Mr Khalid accepted that would be commercial suicide as it would allow Elbrook to cut Horizon out of the chain. Even if it was simply an error it smacks of DDE cutting and pasting chunks from one report to another and undermines the value of the report. The Declaration was also erroneous containing statements about goods being sold with excise duty. It also confirmed Horizon’s VAT number had been hijacked. All of these were red flags that were ignored.

(D) Elbrook did not provide Horizon with its own DD materials until 18 September 2014 when it had commenced trading in April so Elbrook knew Horizon were not doing customer checks.

(E) DDE acted for both Horizon and Elbrook and there would have been a conflict of interest in the commercial world but in this case that was ignored.

In carrying out DD HMRC say that Mr Khalid simply ignored risk factors identified to him and the only explanation is that he knew that the transactions were connected with fraud. It did not matter what the DDE reports said, Mr Khalid was going to and did trade with these counterparties regardless. The DD was mere window dressing. The manner in which Mr Khalid engaged with DD in light of the warnings supports the inference that the transactions were connected with fraud. Elbrook’s reliance on the case of *Linton v HMRC* [2022] FTT (“*Linton*”) is wrong. In that case the Tribunal considered that the flaws in the DD were not such as to show that Linton knew or ought to have known the transactions were connected with fraud. The facts of this case are different. Judge Kempster in *Linton* did not have before him transcripts of conversations and texts between the convicted criminals and Elbrook. In this case it cannot be

sustained that merely because Elbrook retained DDE that it amounted to bona fide DD. HMRC say it was merely window dressing. In *Linton* the company was also part of a buying group but the evidence in that case about the buying group and any preferred DD provider is not in evidence before this Tribunal. HMRC say that the DD reports in this case are a world away from those in the case of *Linton* in respect of which the judge concluded nothing suspicious had been highlighted. In this case even Mr Khalid considered that in relation to three of the reports “*it did not look good*”

(7) No Explanation for the documents recovered from the investigation of the OCG HMRC invite the Tribunal to give weight to the evidence notwithstanding what was stated in the direction. It was understandable for the direction to be issued in that form as Judge Gething had not seen the evidence and knew nothing of the case at the date of the directions but not to give weight to the evidence would be an error of law. HMRC state that the Tribunal may give such weight to the evidence as it sees fit. In addition HMRC say:

(i) Mr Khalid could not provide any explanation of why documents recovered from the OCG named Elbrook, referred to 120 of the transactions in this appeal, referred to commission of 3% being paid to Elbrook and a payment of £7,000 which coincided with a payment in Elbrook’s bank statement. The material demanded an explanation, and all Mr Khalid could say was that Elbrook was not involved.

(ii) When confronted with the references in the transcripts of conversations of the OCG which refer to Elbrook having two mobile phones and two emails and by-passing the Elbrook accounts department, Mr Khalid simply said Elbrook was not involved. HMRC consider that this was an inadequate response. HMRC say the reference to “*I keep the number twos*” shows that the Elbrook accounts function was being circumvented and the Horizon invoice due to arrive in mid 2014 would never appear in the Elbrook accounting records. HMRC investigators confirmed that the second phone belonged to Amjad Khalid.

(iii) Similarly when confronted with extracts of the transcripts of the OCG indicating Mr Rhiaz Khan had called Elbrook’s telephone number, had asked for Amjad, being told Amjad would return his call, referring to his father and brother, a Chelsea football game, and on 13 January referring to Amjad being concerned with “two Tribunals”, the day after HMRC had sent a communication to Elbrook, (the two tribunals being the denial of input tax and the denial of input VAT on the construction of a building owned by Mr Khalid’s brother which dispute was settled on the steps of the Court), Mr Khalid simply said Elbrook was not involved.

(iv) Mr Khalid accepted that cash payments of £100,000 could not leave Elbrook without his involvement.

(v) It is beyond coincidence that the very day that Saad Victoria Food & Wine, a Defaulter Trader in transactions 113 to 138, made a large payment to Elbrook for under bond alcohol.

If the Tribunal accepts that Elbrook and Mr Khalid were “hand-in-glove” with Rhiaz Khan (employee of Golden Harvest) and his associates, it is barely a step to say that Mr Khalid knew that the 335 transactions were connected with fraud. 120 of the

transactions were referred to in the OCG spreadsheets and the directors of Horizon and Golden Harvest were part of the OCG.

(8) No evidence of onward sales

HMRC say that:

- (i) Not a single sales invoice was provided to demonstrate the sale of the thousands of cans of soft drinks which were purported to have been bought by Elbrook under the 335 transactions under consideration.
- (ii) Although Elbrook provided HMRC with sales data which HMRC analysed, Elbrook has done no analysis to counter HMRC's analysis.
- (iii) Mr Khalid said that he was unable to carry out an analysis because of the reallocation of codes. This argument was new, first aired in cross-examination, but was ill-thought out as Mr Khalid had admitted Elbrook had sold the products in question throughout the period.
- (iv) If there had been a reallocation of codes, there would have been more sales than expected not fewer and it would also suggest that without a reconstruction Elbrook can never identify what it had sold in any period, which would be a remarkable state of affairs for a cash & carry business operating on fine margins.
- (v) The inability to demonstrate sales is further evidence of Elbrook's accounting system being circumvented and goes to actual knowledge of the transactions being connected with fraud.

(9) Mr Khalid's evidence

- (i) HMRC invite the Tribunal to infer from the facts that Mr Khalid's evidence was not credible. HMRC refer to four authorities on the issue of the Tribunal's approach to the evidence:

(A) *Whetton v Ahmed* [2011] EWCA Civ 610 which indicates that contemporaneous written documentation is of the very greatest importance when assessing credibility and being significant not only where it is present but also where it is absent. If that contemporaneous written documentation is likely to have existed, and it is not produced, it might be conspicuous by its absence and an inference about its absence may be drawn.

(B) *Kimathi v Secretary of State for the Home Department* [2022] UKUT 00112 in which Stewart J made two observations: The best approach is to base factual findings on inferences drawn from documentary evidence and known or probable facts. That in considering credibility of witnesses it is important to test their veracity by reference to objective fact proved independently of that testimony, in particular by reference to documents in the case.

(C) *Bailey v Graham* [2012] EWCA Civ. 1469, Ch at [47] where Lord Bingham's 1985 article "*The Judge as Juror*" is set out. It lists five main tests for determining when a witness is lying, namely consistency with what is agreed or clearly established by other evidence, internal consistency, consistency with previous statements of the witness, general credit and demeanour.

(D) *Painter v Hutchison* [2007] EWHC 758 Ch [3] where Lewinson J describes Mr Hutchison as a very unsatisfactory witness and gives some indications: “he was evasive or argumentative, he would launch into tangential speeches when confronted with questions that he could not answer consistently with his case, attempt to place a most strained reading on the plain words of his pleaded case, and his principal witness statement, he was free with allegations that his previous solicitor and counsel had made mistakes inaccurately recording instructions, at times he gave self-contradictory answers within a space of a few minutes of his evidence, new allegations emerged in the course of cross examination which had not previously formed part of his pleaded case or his written evidence, it was impossible not to conclude that they had been made up on the spot and finally, his disclosure of documents had been lamentable and highly selective.”

(ii) HMRC advise the Tribunal to treat Mr Khalid’s evidence with the most extreme caution. HMRC consider Mr Khalid’s evidence ticked every box for a witness whose evidence should be judged to be incredible and unless his evidence is supported by contemporaneous documentation HMRC invite the Tribunal to reject it. Specifically:

(A) He was evasive- he had to be asked a question several times, he answered questions with questions.

(B) His written evidence was careless, he claimed Elbrook had never been assessed to VAT but admitted it had been in relation to claims for input tax on the reconstruction of a building owned by his family.

(C) He launched into tangential speeches.

(D) He was contradicted by contemporary written documents – he was 100% sure he had not been aware of MITC before 2012 but there was a clear meeting note dated 2010 to the contrary.

(E) At times he appeared to be “making it up as he went along”, his account of reallocating product codes is an example when explaining why he could not analyse Elbrook’s data. He added new explanations in oral evidence about his belief that cash deposits were bank transfers, additional discounts from Coca Cola local reps, oral credit terms being agreed with Golden Harvest to deal with failure to adhere to the only written term of the contracts for the goods.

(F) He relied on documents he had never produced (despite the length of the time to come to trial) to try to fill gaps in his evidence, such as Google searches that were to contradict Coca Cola’s statement about no lack of supply of products to fulfil orders, documents from Elbrook and the Today Group showing what it purchased and why, destroyed stocktaking papers that were sent to the auditors quarterly to produce management accounts but no request had been made of the auditor to produce them, the quarterly management accounts themselves, the Initial Golden Harvest DD report and questionnaire, the Initial DZ DD questionnaire and documents. The paper stock records would have formed part of Elbrook’s statutory records for the purposes of Section 386(4) Companies Act 2006 and ought to have been retained.

(G) He failed to produce documents that on own his account must have existed such as emails from Golden Harvest containing the company's details, emails asking for stock, phone and fax records supporting his assertion of how goods in these transactions were ordered.

(H) The mere fact that Mr Khalid was not prosecuted alongside the directors of Horizon and Golden Harvest does not mean there is no evidence of his knowledge of the fraudulent transactions. But only that there was insufficient evidence to convict as the burden of proof in a criminal case is beyond a reasonable doubt.

(10) Adverse inferences that can be properly drawn from Elbrook's failure to call witnesses.

(i) HMRC say that Elbrook failed to call as witness anyone who was involved in the transactions although Mr Khalid said on occasion, he wished they were in court to give evidence, namely:

(A) The accounting team comprising Bikal Sitra, Imad Tahir, Ashman Patel and Kamira Patel

(B) The main manufacturer of the products to make good Elbrook's claim about lack of availability of stock. A sales representative that left Coca Cola does not explain the failure.

(ii) (b) HMRC rely on the following authorities:

(A) *British Airways plc v Airways Pension Scheme Trustee Limited* [2017] EWHC 1191 Chat [141] to [143] refers to *Wiesniewski v Central Manchester Health Authority* [1998] EWCA Civ at [94]. If a party does not call a witness, who is not known to be unavailable and/or has no good reason for not attending, and if the otherside has adduced some evidence on that matter, in the absence of that witness the judge is entitled to draw an inference adverse to that party.

(B) The party seeking to rely on such an inference must establish a prima facie case. Brooks LJ relies on the Australian authority *Donnel v Reikhard* [1975] Supreme Court of Victoria at page 96. He states, "*Looking at the authorities from Blatch v Archer, it may be accepted that the effect of a party failing to call a witness who would be expected to be available to such party to give evidence for such a party and who, in the circumstances, would have a close knowledge of the facts on a particular issue, would be to increase the weight of the proofs given on such issue by the other party and to reduce the value of the proofs on such issue given by the party failing to call the witness.*" And at the foot of page 96, Brooks LJ cites Lord Lowry in *Inland Revenue Commissioners ex parte TC Coombs & Co* to the effect that, "*depending on the circumstances, a prima facie case may become a strong or even an overwhelming one, but if the party's failure to give evidence or the necessary evidence can be credibly explained even if not entirely justified, the effect on the silence may be reduced or nullified.*"

(iii) HMRC submit that if the Tribunal is satisfied that there is a prima facie case that Elbrook knew or should have known that its transactions were

connected with fraud, then the tribunal can, if no proper reason has been given for the absence of key witnesses, draw the inference that Elbrook fears to call these witnesses and that is evidence that if they were brought to give evidence they would have exposed facts unfavourable to it. HMRC submit that that adverse inference goes to bolster the conclusion HMRC invite the Tribunal to reach from the other nine strands.

(iv) HMRC submit that when the above nine threads are drawn together there is a compelling case of actual knowledge on Elbrook's part that these transactions were connected with fraud.

(v) In the alternative, HMRC submit that there was no reasonable explanation for the circumstances of these transactions other than their connection with fraud. Elbrook was well aware of the risk of VAT fraud, the indicia of VAT fraud and that its own transactions had been traced to fraudulent tax losses. In some cases its suppliers were able to supply it at prices that it could not beat, despite its 30 years in the market and its membership of a buying group. In the majority of cases it purchased from suppliers despite being able to purchase more cheaply from the manufacturer. The deal documentation is inconsistent with the reality of the transactions. The payment structure of being apparently lavished credit of this extent is too good to be true. Elbrook had not availed itself properly of the checks it said it was going to undertake. It failed to properly assess the commercial viability and bona fides of its counterparties and failed to ask the basic questions as to why it was being invited to participate in these transactions. On the "should have known" limb where one has to consider all the circumstances, HMRC submit that when one does, it is obvious that the only reasonable explanation for the totality of the features of these transactions is that they were connected with the fraudulent evasion of VAT, and on either basis, HMRC therefore invite the Tribunal to dismiss the remaining appeal.

ELBROOK'S CASE

196. Elbrook says in relation to the denial of input tax, it is for HMRC to prove that Elbrook knew or ought to have known that the only reasonable explanation for the 335 transactions was that they were connected to fraud and HMRC has failed to discharge the burden of proof generally and specifically:

- (1) HMRC has failed to show that there was a tax loss in the Sparrowhawk chain.
- (2) If there were such a loss HMRC has failed to show the loss was brought about fraudulently.
- (3) HMRC has failed to show DZ was part of an orchestrated fraud.
- (4) HMRC has failed to show that Elbrook knew the 335 transactions were connected to fraud.
- (5) HMRC has failed to show that Elbrook ought to have known that in the circumstances the only reasonable conclusion was that the transactions were connected to fraud.

197. **Sparrowhawk.** In relation to Sparrowhawk, Elbrook says the alleged tax loss relates to two invoices of supplies to Elbrook which HMRC allege were not reflected in the VAT return made by Sparrowhawk. The return showed outputs of £1,387,930. Elbrook says that:

- (1) Officer King admitted that she had no way of knowing whether the two invoices were included in the return. HMRC has therefore been unable to prove there has been a loss of output tax.
- (2) HMRC failed to enquire into the VAT return once submitted by Sparrowhawk and Officer King confirmed that HMRC withdrew the assessment for the alleged loss of tax.
- (3) Further, even if there was a loss, HMRC has been unable to prove it was created by fraudulent conduct.

198. **DZ.** In relation to DZ, the alleged tax loss arose when HMRC denied DZ input tax on purchases from five traders including a purchase from Sparrowhawk. Elbrook says that HMRC has failed to show that the tax losses were fraudulent in accordance with the two-stage test laid down by the Supreme Court in *Ivey v Genting Casinos (UK) Ltd t/a Crockfords* [2017] UKSC 67 at [74], namely

- (1) The first step is to ascertain the subjective state of mind of the person said to be dishonest, and
- (2) The second step is to determine objectively whether his conduct was dishonest according to the standards of ordinary people.

199. Elbrook says that the denial of input tax by HMRC did not appear to be based on dishonesty and HMRC has not proved dishonesty. Further Elbrook notes that Mr Zylfo the director of DZ attended 18 meetings with HMRC between May 2014 and April 2016 and that is not the behaviour of a dishonest person.

200. **Elbrook's knowledge of fraud.** Elbrook says that:

- (1) There is no direct evidence on which HMRC rely to show that Elbrook knew its transactions were connected with fraud. Whereas Elbrook largely accepts that the transactions were connected with fraud, that does not mean that Elbrook was a knowing participant. Elbrook points to a statement made by lady Hallett in *HMRC v Citibank NA & Anor*, (“*Citibank*”) at [102] that “*reputable companies may get caught up in a MTIC fraud unknowingly*”.
- (2) Officer Ginn's evidence that the majority of the products purchased by Elbrook pursuant to the 335 transactions had vanished, is based upon HMRC's analysis of the Elbrook's records which was converted into another format to enable HMRC to undertake the analysis but which has not been provided to Elbrook only a summary of the alleged results. Elbrook effectively says this analysis is unreliable because SAGE was never used for stock. Elbrook kept a paper record which was given to the auditors quarterly. The SAGE system has a counter and once it reaches 9,999 it reverts back to zero. Elbrook's records show the goods were sold and the VAT declared and output tax accounted for.
- (3) Mr Ginn has asserted that Elbrook underpaid Golden Harvest by £161,254.28 which figure was taken from a schedule produced by Mr Ginn at PG138. Elbrook says the schedule does not include figures which correspond directly to the alleged under payment.
- (4) The criminal convictions of the directors of Golden Harvest and Horizon is evidence of the state of mind of those directors, that they knew what they were doing was fraudulent. The same is not true of both Mr Fukhera and Amjad Khalid who were interviewed under caution in respect of the offences of which the Golden Harvest and Horizon directors were convicted but the Khalid brothers were never

charged. HMRC instigated enquiries into Mr Khalid's affairs under Code of Practice 9 for suspected fraud which offers immunity from prosecution which offer was not accepted by Mr Khalid, in 2012 under Code of Practice 8, both of which were closed in 2022 without assessment. HMRC also instituted enquiries in to Elbrook's affairs in 2008 which also closed without assessment. Elbrook was also subject to the Anti Money Laundering visits by HMRC without any consequence. HMRC has no evidence of fraud on behalf of Elbrook.

(5) The evidence obtained by HMRC during the investigation of the OCG which led to the criminal conviction of the directors of Golden Harvest and Horizon was admitted by a direction that no weight should be given to it and Elbrook invited the Tribunal to uphold that direction. Alternatively, Elbrook says as follows:

(i) The recordings were made 6 months after Elbrook ceased trading with Golden Harvest and Horizon in 2014.

(ii) HMRC has no evidence that the second mobile phone is that of Mr Khalid or Elbrook, not have they produced evidence of a second email account.

(iii) Officer Ginn could find no correlation between the 3% commission in the spreadsheets and Elbrook's bank statements.

(iv) There is a reference to £7,000 being paid to Elbrook and a payment in the bank statement of £7,000 but no annotation.

(v) There is a reference to a Mr Riaz Khan allegedly calling Elbrook on the phone and a reference to an invoice will be with you from Horizon. There is no such invoice in Elbrook's records.

(vi) Elbrook points to the summing up of the judge in the criminal trial at which Mr Riaz Khan was convicted, on which HMRC place great store, to the effect that the arrangements were sophisticated, the traders including the buffer traders had the trappings of legitimate traders and the entire arrangement needed great organisational skill and constant vigilance in coordinating documentation and the façade of a legitimate trade, including VAT registration and schooling of players in handling HMRC officers. Elbrook says that HMRC were duped by Golden Harvest and Horizon. So was Elbrook. Elbrook points to the state of HMRC's knowledge of both companies' activities. HMRC were monitoring Golden Harvest and Horizon closely. Golden Harvest was deregistered two or three times, HMRC knew Golden Harvest was dealing with defaulting traders in 2011. Golden Harvest was on the monitoring programme and had to produce records every month. Tax loss letters were sent to it in July 2013. HMRC knew its business was "unviable". Horizon was de-registered in a six-minute visit to its offices. The director said he was no longer going to deal in alcohol but did so on a large scale. He was a single director in a shared space office yet designated low to medium risk by an Officer of HMRC. In relation to DZ, HMRC Officers visited the officers 18 times between May 2014 and April 2016. Elbrook and HMRC were duped.

(vii) HMRC were slow to take steps to deregister Buffer Traders. HMRC had powers to obtain information from such traders, monitored them closely but allowed the Buffer Traders to continue trading even after HMRC suspected them of being engaged in fraudulent trading.

(6) HMRC's position that Elbrook must have known as Horizon and Golden Harvest would not wish to engage with an innocent party who might blow the whistle. But fraudsters do involve reputable companies in MTIC fraud as acknowledged by Lady Hallett in the *Citibank* case. It is not a requirement for a fraud of this nature for the end trader to be engaged with the fraud. Selling to a legitimate business is the best disguise and protection of a fraudster.

(7) HMRC place great store by the fact that there were chains of traders of differing lengths, that the transactions were back-to-back and there were no anomalies in the documentation, and there were very small mark-ups for those at the beginning and middle of the chain, but these indicators are insufficient to show that Elbrook had actual knowledge that the transactions were connected with fraud. HMRC has no direct evidence of Elbrook's actual knowledge. Further Elbrook notes that HMRC has argued the presence of anomalies in documentation is evidence of fraud in MTIC appeals as in *Link Distribution v HMRC* [2017] UKFTT 69 at [162]. Elbrook says HMRC appear to ride two horses at the same time.

(8) Elbrook point to the case of *Crow Metals Ltd v HMRC* [2020] UKFTT 423, a case decided on the facts in favour of the taxpayer despite there being 400 transactions, an absence of contracts and poor DD, and invite the Tribunal to find that there is no evidence that Elbrook knew of the fraud.

201. Whether Elbrook ought to have known, Elbrook points to the decision in *Mobilx* at [75] which sets out the test and states that "the ultimate question is not whether the trader exercised due diligence but, rather whether he should have known that the only reasonable explanation for the circumstances was that it was connected to fraud." This Elbrook says:

(1) Is a question of fact for the FTT to determine. It requires consideration of what a reasonable person would conclude. Would the reasonable person conclude that the **only explanation for** the circumstances was that it was connected with fraud. It must be determined by reference to the facts of the case following *Davis & Anor v HMRC* [2016] STC 1236.

(2) The FTT is entitled to look at the totality of the 335 transactions, what Elbrook did or omitted to do and what it could have done, together with the surrounding circumstances.

(3) The FTT may not take into account the items listed in para [192(7)] above if the FTT finds that Elbrook did not know the transactions were connected with fraud. What matters is the perspective of Elbrook.

(4) HMRC relies on the same factors to show that Elbrook knew of the fraud to demonstrate that Elbrook ought not to have known.

(5) Elbrook says no adverse inferences should be drawn from the fact that the one person Mr Khalid had contact with, Mr Divyesh Karsan, the director of Golden Harvest has not been called as a witness. Elbrook accepts that Mr Karsan has no credibility. Nothing can be gained from calling him as a witness.

202. In response to points made by HMRC on some of the facts and circumstances, Elbrook says:

(1) HMRC seem to say it is suspicious if Elbrook pays more or pays less, than the manufacturer's price for goods. Surely it can't be both.

- (2) Mr Khalid explained that he was prepared to pay more ostensibly to avoid tying up capital as it could take a year to get the discount from the Today Group. That is a normal commercial consideration. Cash is king in a cash & carry business.
- (3) In relation to the so called “missing cases” of soft drinks Mr Khalid explained why he could not identify the cases sold from the sales data. Mr Khalid had no knowledge of how the officers had interrogated Elbrook’s data. Mr Khalid explained the reallocation of codes from one product to another so it would be impossible to know the sales of the goods formally under that code. And once a code is allocated to a new product the sales of the new product would appear artificially high.
- (4) In relation to the paper stock records that were not kept by Elbrook, there was no requirement to keep them for VAT purposes because stock records are not statutory records for the purposes of VAT. For VAT all that is required is a record of sales and purchases.
- (5) In respect of damaged goods, Elbrook wonders why bother recording damaged goods if the arrangement is a fraud?
- (6) In respect of cash transactions, Mr Khalid had informed officers that he had completed a form W-7 in respect of £11m cash received at its offices. Mr Khalid did not understand that Elbrook had to complete a W-7 for cash deposits received by a bank on Elbrook’s behalf.
- (7) In respect of DD Elbrook undertook and the adverse comments made by HMRC in respect of it, Elbrook points to the FTT decision in *Linton v HMRC* [2022] FTT where Judge Kempster accepted that there were flaws in the DD reports prepared by DDE, errors of a typographical nature, references not followed up, but concluded that the company had acted responsibly in appointing an independent firm, it did consider the reports and on one occasion queried the contents of the report. Judge Kempster says at [(6)] on Page 219, “*There was nothing in the reports to suggest that its dealings would be any different from those conducted in the past and nothing suspicious was highlighted.*” Elbrook says that in relation to Apex, Maryam and Pivotal the Tribunal had seen how Mr Khalid had reviewed the DD reports on more than one occasion, but nevertheless satisfied himself that it was safe to trade. Undertaking continual DD at a cost has to be the behaviour of a legitimate business. Elbrook says it did not know and there is insufficient evidence to prove that Elbrook ought to have known the transactions were connected with fraud.
- (8) In relation to the tax loss letters sent to Elbrook to the effect that HMRC had suffered losses of £2m from six transactions. The letter indicates that HMRC may deny input tax to Elbrook in respect of transactions if it is shown that Elbrook knew or ought to have known that Elbrook were participating in a supply chain connected with the fraudulent evasion of VAT. It then urges Elbrook to ensure the DD it undertakes is commensurate with the risk and to satisfy itself of the integrity of Elbrook’s suppliers and customers. Elbrook points out there was no VAT denial in respect of these transactions. HMRC accept that no assessment was made.
- (9) Elbrook says the issue of lack of stock on the part of Coca Cola has been misunderstood. Elbrook say there is a difference between Coca Cola being unable to deliver all that had been ordered by Elbrook on the one hand and could Coca Cola always supply what Elbrook wanted. The wrong question was put to Coca Cola. Further Coca Cola had no information for 2012 to 2014 on lack of stock.

Elbrook says Mr Khalid did not confine his reasons for buying from Golden Harvest and Horizon to solely lack of stock.

(10) In relation to lack of commerciality in the transactions, Elbrook says it is open to parties to a contract to vary its terms at any time. That is the real world in which cash & carries operate. No one hangs on to stock. There were fluctuations in the prices at which Elbrook bought goods from Golden Harvest.

(11) In relation to the comment supposed to have been made by Mr Khalid about being subject to two tribunals, it could not have been made by Mr Khalid as there were no appeals to the Tribunal in relation to Elbrook.

(12) In relation to inferences that may be drawn from failure to produce witness statements such as employees, Mr Khalid was of the opinion that he had the knowledge to deal with the 335 transactions. He carried out the DD.

(13) As for HMRC's assertion that Mr Khalid failed to justify why Elbrook was approached to participate in the transactions, the answer is obvious, Elbrook was a cash & carry and it sold the products on offer.

In conclusion, Elbrook say there is no evidence that Elbrook had actual knowledge and insufficient circumstantial evidence to draw an inference that Elbrook ought to have known, that the transactions were connected to fraud such that the only reasonable explanation for the transactions was that they were connected to the fraudulent evasion of VAT.

DISCUSSION

203. For HMRC to deny the claims by Elbrook to deduct input tax of £1,273,741.55 in respect of the 335 transactions under consideration in accordance with the decision CJEU in *Kittel*, HMRC must prove on a balance of probabilities that:

- (1) Each of the 335 transactions were connected with a fraudulent loss of VAT.
 - (i) Elbrook has accepted that 334 of the transactions were connected to the loss of tax. Elbrook disputes that the transaction chain including Sparrowhawk involved a loss of tax.
 - (ii) Elbrook accepts that 331 of the transactions were part of an orchestrated scheme to defraud HMRC i.e., they were connected with the fraudulent evasion of tax, but denies that the 4 transactions involving DZ were part of such a scheme.
- (2) Elbrook either:
 - (i) knew that the transactions were connected with a fraudulent loss of tax, or
 - (ii) ought to have known that the transactions were connected with a fraudulent loss of tax. Mosses LJ identified the correct test of when a taxpayer ought to have known in *Mobilx* at [77], "*That ... could be established by demonstrating that it ought to have known that the only reasonable explanation for the circumstances in which the transactions in question were undertaken was that they were connected with fraud.*" *Moses LJ* also commented on the impact of a taxpayer's failure to deploy knowledge [52] "*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.*"

204. As indicated in *Citibank*, at [90] it is not necessary for the taxpayer to be dishonest or to know the identities of the fraudulent defaulters.

205. A taxpayer will be regarded as having knowledge to the only reasonable explanation standard if he fails to make enquiry, per Davis & Dann at [64].

206. Lady Justice Arden also stated in Davis & Dann that the Tribunal must not compartmentalise the evidence [60] and is not restricted by any rule of law or statute from relying on any circumstance which was capable of being probative of knowledge to the no other reasonable explanation standard [62].

207. Elbrook:

(1) denies that it had actual knowledge that the transactions were connected with fraud, and

(2) considers that HMRC has not discharged the evidential burden and the only reasonable conclusion that ought to be drawn from the facts and circumstances is not that Elbrook ought to have known that the transactions were connected with fraud.

Mr Khalid's Evidence

208. Before considering the specific aspects of the case we wish to comment on Mr Khalid's evidence. Our impression of Mr Khalid was that he was an intelligent man and his father and brother had trusted him to run the family cash & carry business albeit with some assistance from his brother Fukhera. However, we set out at [195 (9)] above the authorities HMRC rely on to invite the Tribunal to treat Mr Khalid's evidence with caution and to infer from the facts that, except where Mr Khalid's evidence is supported by contemporaneous documentation, Mr Khalid's evidence was not credible. We agree with the eight comments made by HMRC on the quality of Mr Khalid's evidence at 195(9)(ii)(A) to (H), we agree that it is appropriate to treat Mr Khalid's evidence with caution and to draw an inference that except where his evidence is supported by contemporaneous documentary evidence that his evidence is not credible. We also agree that Elbrook failed to provide any witness with knowledge of the SAGE accounting software, able to comment on HMRC's analysis of the data provided by SAGE or to conduct its own analysis to demonstrate why HMRC's analysis was incorrect. Elbrook failed to produce any of the buyers in the warehouse team to give evidence of whether they ascertained the price being offered to the Today Group before doing so. Elbrook also failed to provide evidence or witnesses from Coca Cola and GSK on their inability to supply stock or even on the prices at which Elbrook could purchase goods from Coca Cola and GSK in the period. These failures seem to us inexplicable except on the basis that to do so may have exposed unfavourable facts.

209. In relation to stock records, these were needed by Elbrook's auditors to prepare the quarterly accounts and therefore the annual accounts. Section 386(4) of the Companies Act 2006 is clear that a company must state the level of stock at the end of each financial period and must retain all statements of stock takings from which that statement of stock in the accounts has been prepared. In cross examination Mr Khalid said the paper stock records had been destroyed. It is clear that the weekly paper stock records that were prepared and handed to Elbrook's accountants to prepare the statutory accounts ought to have been retained. Elbrook ought to have asked their accounting advisers for copies and we find the failure inexplicable except on the basis that to do so may have exposed unfavourable facts.

Evidence from the OCG

210. At a preliminary stage in the course of these appeals Judge Gething was invited to make a direction to admit evidence from the OCG hearings. Judge Gething was unaware of the issues in the case and was being asked to give directions. She allowed the evidence to be admitted as

to do otherwise could be unjust but indicated that no weight would be attached to it. Judge Gething was not in a position to understand what weight should be given to it. The Tribunal was asked by Elbrook to maintain that position. HMRC asked the Tribunal to alter that position and afford the evidence such weight as the Tribunal sees fit. We modify the original direction and allow the evidence some weight to the extent that it corroborates other evidence. We do not wish to give the impression that enormous weight should be placed upon it. The OCG evidence is a small piece in comparison with the 15,000 pages in the Trial Bundle.

Sparrowhawk transaction.

211. We infer from the facts set out at [132] to [137] above that Sparrowhawk is a fraudulent defaulting trader and that a loss of VAT has arisen on sales to DZ because the claim to input tax in the late filed VAT return for 04/14 was overstated.

212. Specifically, we note that the mark up on £1,387,442 of alleged purchases set out in Sparrowhawk's return was a mere £488. In our view, no trader could realistically conduct business on such a tiny margin.

213. We also note that HMRC has not been provided with the VAT invoices to enable it to verify the purchases and sales set out in the 04/14 return.

214. We note that the 04/14 return was only submitted in October 2014 after HMRC had in September 2014 suspended the VAT registration with effect from 1 June due to lack of contact from Sparrowhawk, and had issued a VAT assessment to recover the output tax on the sales to DZ in the sum of £3,484.

215. Further if Sparrowhawk's business had been legitimate and had generated over a million pounds worth of sales in three months, it would be logical for Sparrowhawk to contact HMRC to reinstate the VAT registration number. We infer from Sparrowhawk's failure to reinstate the VAT registration number that the business was not legitimate. We further infer from the information above that the input tax was overstated deliberately creating a tax loss.

The DZ transactions part of an orchestrated scheme to defraud HMRC

216. To deny Elbrook's input tax claim in respect of the four transactions involving DZ, HMRC must prove on a balance of probabilities that DZ were part of an orchestrated scheme to defraud HMRC, i.e. that DZ were connected with the fraudulent evasion of tax.

217. Elbrook say that HMRC has not satisfied the test laid down in *Ivey v Genting Casinos (UK) Ltd t/a Crockfords* [2017] UKSC 67 ("**Crockfords**") at [74], concerning establishing fraud. The is a two-step approach:

- (1) The first step is to ascertain the subjective state of mind of the person said to be dishonest, and
- (2) The second step is to determine objectively whether his conduct was dishonest according to the standards of ordinary people.

218. We set out the text of [74] in *Crockfords* below:

"[74.] ... The test of dishonesty is as set out by Lord Nicholls in Royal Brunei Airlines Sdn Bhd v Tan and by Lord Hoffmann in Barlow Clowes: see para 62 above. When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct

was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement that the defendant must appreciate that what he has done is, by those standards, dishonest.”

219. Elbrook also says that the denial of input tax by HMRC did not appear to be based on dishonesty and HMRC has not proved dishonesty. Further Elbrook notes that Mr Zylfo, the director of DZ, attended 18 meetings with HMRC between May 2014 and April 2016 and that is not the behaviour of a dishonest person.

220. We consider that there is sufficient evidence of Mr Zylfo’s knowledge and belief as to the facts to enable the Tribunal to conclude that Mr Zylfo was aware that DZ was part of an orchestrated scheme to defraud HMRC when the following is considered together:

- (1) It is clear Mr Zylfo was aware of the issue of Missing Trader Fraud in Elbrook’s supply chain in 2012 and 2013,
- (2) The extraordinary fact that all DZ’s suppliers became deregistered or missing traders shortly after the transactions with DZ,
- (3) DZ undertook 84 transactions with three suppliers in three months all of which ended up in tax losses,
- (4) Not even rudimentary DD appears to have been undertaken,
- (5) DZ made no commercial contribution to the transactions, turned a profit and yet was not excluded from the chain which was eminently possible given the goods were to be delivered to DZ’s customer,
- (6) Mr Zylfo’s admissions at various meetings with officers of HMRC of being involved in back-to-back trading with the goods being delivered to Elbrook and not first to DZ,
- (7) Mr Zylfo’s admission that he regretted having been caught up in tax loss fraud,
- (8) Mr Zylfo’s admission that he had been badly advised in relation to the back-to-back trading,
- (9) Mr Zylfo’s reluctance to provide documents,
- (10) DZ’s change to retail trading, and
- (11) DZ’s own deregistration following receipt of the input tax denial letter,

221. Further we consider Mr Zylfo’s conduct judged by the standards of the ordinary decent person would be regarded as dishonest.

Whether Elbrook knew or ought to have known that the 335 transactions were connected with fraudulent evasion of tax

222. We reject the suggestion made by Elbrook that the Tribunal should follow the decision of the FTT in *Crow Metals*, where there were issues of inadequate DD. We decline to do so. It is the purpose of authority to give guidance on the law not to find analogy on the facts.

223. We now address the circumstances in which the 335 transactions took place in the VAT quarters ending 04/12 to 07/14 and Mr Khalid’s knowledge of the circumstances:

- (1) Cash & carry businesses operate on very fine margins.
- (2) Mr Khalid had been a director of Elbrook and responsible for soft drinks purchasing since 2002. He had had 10 years’ experience in the soft drinks trade by

the beginning of VAT period 04/12 in which the first of the 335 transactions occurred. Mr Khalid accepted in cross examination that he was nobody's fool.

(3) On 26 September 2007 Mr Khalid was sent a letter to raise awareness of MTIC fraud in wholesale commodities enclosing Notice 726 (which explains MTIC fraud, the concept of joint and several liability, the necessity to undertake DD on customers and suppliers and the need to scrutinise the commerciality of the terms of any trade) which Mr Khalid had no recollection of reading but he accepted had he read it he would have been aware of MTIC in 2007.

(4) Mr Khalid admitted to Officer Ginn that he was aware of MTIC fraud from 2010 at the latest and had read Notice 726.

(5) On 25 May 2012 HMRC sent to Elbrook a letter enclosing a link to Notice 726 and a leaflet "How to spot MTIC fraud". Mr Khalid recalled reading the letter but not the leaflet.

(6) Mr Khalid accepted that Elbrook received letters from HMRC informing Elbrook of the de-registration of Elbrook's suppliers in the wholesale sector on 11 June 2010, 22 December 2010, 29 December 2010, 30 December 2010, 23 February 2011, 23 February 2011, and 24 February 2011.

(7) In his witness statement Mr Khalid said the only step he took on receiving deregistration letters was to cease trading with the supplier as Elbrook would be unable to recover VAT. In cross examination he said he would have called the supplier because deregistration could have been voluntary, and he would stop trading with the supplier until the issue was sorted out with HMRC. There was no written evidence of any such contact with suppliers.

(8) Mr Khalid accepted that Elbrook received tax loss letters in relation to transactions previously entered into by Elbrook with many suppliers:

(i) With three suppliers, JRP Trading Ltd, Mondeo and Myah, in a letter dated 4 May 2011.

(ii) With five of its suppliers on 10 May 2011, 23 May 2011, 23 May 2011 and 27 September 2011.

The letters directed Elbrook to satisfy itself of the integrity of its suppliers, warned that Elbrook could be denied input tax deduction if upon enquiry it is shown Elbrook knew or ought to have known that these transactions were connected with fraud.

(9) In cross examination Mr Khalid said Elbrook would not cease trading with a tax loss company unless HMRC had also raised an assessment against the tax loss company to recover the tax. Mr Khalid also said he did not link deregistration and tax loss in a supplier with fraud in the supply chain. We find this impossible to believe considering how many tax loss letters Elbrook had received in 2011 alone which directed Elbrook to check its suppliers and indicate that HMRC could deny Elbrook an input tax deduction in respect of the lost tax.

(10) In cross examination Mr Khalid admitted that Elbrook's supply chain was in trouble in 2011.

(11) Mr Khalid said in cross examination that he reviewed Elbrook's DD processes after receipt of each tax loss letter to ensure they were as stringent as possible. We consider this statement to be inconsistent with Mr Khalid's statement

that he would carry on trading with the supplier until HMRC issued an assessment on the supplier to recover the VAT. We also consider it is unlikely that Mr Khalid scrutinised the DD process given that there is no written record of the DD process being reviewed, apart from the second DD report from DDE on Golden Harvest which revealed red flags which were then disregarded by Mr Khalid there is no evidence of Mr Khalid reviewing his suppliers, and no evidence of him requesting his suppliers to check their own supply chain.

(12) Indeed, Elbrook's scrutiny of suppliers was far from stringent. This can be seen from the DD documentation Elbrook only produced during the hearing relating to three companies Apex, Pivotal and Maryam (which was carried out in 2014 after the DD for each of Golden Harvest, Horizon and DZ). When inconsistencies and red flags in the suppliers' replies on the DD reports were identified by Mr Khalid, he either ignored them or apparently reasoned them away on various grounds including that the suppliers had made clerical mistakes.

(13) Further, Elbrook began trading with Golden Harvest on 5 March 2012 without the benefit of any DD. A DD report from DDE was produced 6 months after Elbrook began trading with Golden Harvest and did not contain any financial assessment of Golden Harvest because Golden Harvest had not provided information. This failure by Golden Harvest should have raised concerns. Mr Khalid seems to have turned a blind eye to this issue.

(14) A second report by DDE on Golden Harvest dated 25 September 2012 shows that Elbrook knew that Golden Harvest had a turnover of £30m and had a single director. Elbrook knew these to be red flags. Elbrook made some written comments on the DD report, but these particular issues were not red flagged nor were they acted upon. It seems to us that Mr Khalid had turned a blind eye to the issues.

(15) Elbrook began trading with Horizon on 1 April 2014. No DD documentation was produced for Horizon. We assume no DD was undertaken. Mr Jayesh Shah was the sole director of Horizon. This would have been a red flag had there been any DD. In the six-week period from 1 April to 14 May 2014 Elbrook had entered into 20 transactions with Horizon with a value in excess of £350,000.

(16) Elbrook undertook 4 trades with DZ between 2 April 2013 and 1 April 2014. DD documentation relating to DZ comprised an exchange of emails dated 20 November 2014 and 3 December 2014 which was more than 6 months after the last deal with DZ. DDE acted for both DZ and Elbrook but no conflict of interest was recognised by Mr Khalid. This DD was an after-thought at best and window dressing at worst.

(17) Mr Khalid said in cross examination that he considered the DD Elbrook undertook was for the protection of Elbrook and not HMRC. We do not find this statement credible.

(18) The rationale for Elbrook joining the Today Group was to enable Elbrook to be able to purchase goods from manufacturers at a price to enable Elbrook to compete with larger cash & carry chains and supermarket chains. The Today Group had accounts with each of GSK and Coca Cola. The prices at which Elbrook could buy goods from each of Coca Cola and GSK were significantly below the list prices as the result of the availability of "on invoice" discounts. Other discounts were available for volume purchases and were paid by GSK and Coca Cola at the end of the trading period to the Today Group which then distributed the bonuses to its members according to the volume of goods purchased.

(19) In his witness statement Mr Khalid had said the reason Elbrook had bought goods from Golden Harvest, Horizon and DZ was because Coca Cola and /or GSK were unable to supply the volume of goods requested by Elbrook.

(20) No evidence was produced by Mr Khalid of the manufacturers inability to meet Elbrook's requests in the 30-month period under consideration, notwithstanding that Mr Khalid had said in earlier correspondence with HMRC that he had such written evidence. Evidence obtained by HMRC from the manufacturers indicated that lack of availability of stock was unlikely.

(21) Mr Khalid said for the first time in cross examination that the reason Elbrook had purchased goods from Golden Harvest, Horizon and DZ was because the prices offered by them were lower than those offered by GSK and Coca Cola. Mr Khalid said this was so, even though neither of Golden Harvest, Horizon or DZ were members of the Today Group, because Golden Harvest bought from competitors of Elbrook, i.e. cash and carries. We can accept that periodically a competitor of Elbrook may be offering a product such as coke as a loss-leader, but we find it impossible to believe that on each of the 320 occasions when Elbrook bought goods that it was possible for Golden Harvest to have acquired goods at a lower price. Such availability of low priced goods would in our opinion be too good to be true. Mr Khalid's admission shows that he knew Golden Harvest was in a supply chain.

(22) No evidence was produced by Mr Khalid of the prices at which GSK and Coca Cola were offering soft drinks to Elbrook via the Today Group in the 30-month period.

(23) Analysis undertaken by HMRC of the purchase data and information obtained for 2012 of the on-invoice discounts that would have been available to Elbrook via the Today Group, showed that in all but two cases in 2012, Elbrook could have acquired the goods from Coca Cola more cheaply than from Golden Harvest.

(24) Mr Khalid said in cross examination that some off invoice discounts offered by manufacturers were received after the end of the financial period in which the sales occurred and that he did not wish to tie up capital until it was received so he bought at the higher price being offered by other suppliers. This made no commercial sense to us, especially as it was impressed upon us that cash and carry businesses operate on tight margins. Also, Mr Khalid failed to produce any evidence of the impact of the cost of tying up capital on prices. These off-invoice discounts would have made purchasing through the Today Group more compelling not less.

(25) Mr Khalid was aware of the prices Elbrook paid to each of Golden Harvest, Horizon and DZ. Mr Khalid was therefore aware of the lack of fluctuation in those prices over the 30-month period with Golden Harvest and Horizon. The prices offered by the manufacturers fluctuated up and down throughout the 30-month period. These prices were in our opinion too good to be true.

(26) Mr Khalid said in cross examination that Elbrook conducted a stock take once a week. This was a physical exercise. Records were only kept manually. His team used a piece of paper with two columns. In one column he had the list of products. The other column was to record the stock in the warehouse. The warehouse team would physically check the stock and insert the amount of stock. The buyers would use this to decide how much stock to buy. Mr Khalid also said in cross examination that once he had approved a supplier the buyers could place

orders with them. The orders were recorded on the stock sheets. We find it extraordinary that the team were not first directed to contact Elbrook's sales representatives at Coca Cola and GSK to ascertain the sale prices of the relevant soft drinks being offered to Today Group members before placing an order with Golden Harvest, Horizon and DZ.

(27) We also find it extraordinary that in any single week Horizon issued two or three invoices to Elbrook. Each invoice records the goods and the prices from which it can be deduced that the quantities were almost identical although the price may vary slightly. With a weekly order system, one would expect a single invoice or if multiple invoices are issued one would expect the second and third invoices to be for part orders of varying amounts of product and values. The same is true of Golden Harvest invoices and although there are only 4 invoices issued by DZ, they are dated 1, 2 and 3 April and 12 April, the invoices in the first week of April were for coke, coke/diet and coke and the prices were £3,542.40, £3,283.20 and £3,484.80. The data available in relation to the purchases from the manufacturers shows that where there are multiple invoices in a single week the value of the goods in later invoices is much smaller, as one would expect where part orders are being delivered.

(28) Elbrook did not keep a copy of the manual paper stock records and has not produced them in evidence. Elbrook gave the paper records to their accountants to produce quarterly management accounts and did not ask for their accounting advisers for a copy to produce in evidence. As noted above, Elbrook was required to retain the stock records from which the statutory accounts were prepared. We have discussed this failure at [201] above. We draw an adverse inference from the failure to retain and produce.

(29) HMRC conducted an analysis of the Coca Cola and GSK soft drinks purchased using data obtained from the SAGE accounting system. HMRC concluded that Elbrook had purchased 6.4 times as much stock as it had sold in the period, but the surplus stock was not in the warehouse. Elbrook failed to produce as a witness a person capable of scrutinising HMRC's analysis of the data it extracted from SAGE. As mentioned above we draw an adverse inference from that failure.

(30) Elbrook did not use the SAGE accounting software to monitor stock.

(31) Elbrook knew the software in the point of sale(till) system did not record the identity of the purchasers and had no invoices at all in relation to the sale of the goods acquired pursuant to the 335 transactions.

(32) Elbrook had no formal written contracts in place pursuant to which the 335 transactions were done in the 30-month period, nor any emails or other document recording the transactions, or the negotiation and agreement to the terms including price, provision of credit in cases where payment was made after the stated date of delivery, nor any term dealing with damaged goods. We recognise that orders can be placed by phone but that there is no email traffic at all seems to us incredible given the large number of transactions over a 30-month period which had a value of c.£6m and the VAT attributable to them was £1,273,739.55.

(33) In cross examination when Mr Khalid recognised that Elbrook had paid late for goods although the documents produced by Golden Harvest and others specified that they required payment on delivery, the only written term of the contracts other than the identity of the goods and price. He tried to construct a

narrative about the cost of credit but this was unconvincing in light of the large values and the length of the period for which payment was outstanding. The lack of charge for the credit seems to us incredible given the high value of the transactions. It was too good to be true.

(34) Mr Khalid's disinterest in the integrity of the supply chain is manifest when, after the 30-month period under consideration, and receipt of large numbers of tax loss letters one would have expected him to have stepped up his vigilance in relation to the integrity of suppliers but instead he began trading with Maryam. Maryam's sole director had been a director of Myer Ltd, which company was previously a supplier to Elbrook and Elbrook knew had been deregistered and had caused a tax loss to HMRC. Mr Khalid was subsequently willing to sell £60m of alcohol to Maryam in bond which it on-sold to Hasselt for which cash payments were made in France in sterling and deposited in banks in the UK because Mr Khalid said French banks could not receive sterling cash deposits. He conducted this business notwithstanding that cash payments in the alcohol trade were a definite red flag of fraudulent trading and he knew the director of Maryam had been the sole director of Myer.

(35) We find the number of damaged goods to be exceptionally high and find it strange there was no documentation recording any complaint. The marking up of the invoices and Mr Khalid's explanation that only one or two cans in each case were damaged and they were repacked to be inconsistent. We consider it is possible this was done to help explain the lack of stock in the warehouse.

(36) Mr Khalid denies any knowledge of the OCG notwithstanding that:

- (i) Documentation was recovered that records 120 of the 335 transactions with which this case is concerned,
- (ii) Another document recovered lists Elbrook among a number of companies with a prescribed percentage allocated to Elbrook per transaction,
- (iii) Transcripts of conversations of members of the OCG refer to Elbrook, Amjad, his brother and father both of whom worked in the cash & carry business, Bikal who worked in the accounts team and that Amjad wishes to receive only "halal" transactions owing to him having two appeals against HMRC.
- (iv) A transcript states that Mr Khalid has two mobile phones one of which is a pay as you go phone which HMRC has been able to confirm is the phone used by Mr Khalid to make calls to the OCG.

(37) Mr Khalid points to him not having been prosecuted along with members of the OCG. We note the burden of proof in criminal proceedings is to the higher standard of beyond a reasonable doubt. In these proceedings the burden of proof is the civil standard of the balance of probabilities. That Mr Khalid has not been prosecuted does not denote that on the balance of probabilities Mr Khalid had no knowledge or should have had no knowledge.

(38) Mr Khalid also points out that he had in the past been subject to Code of Practice 9 enquiry, which enquiry was closed and no tax was found to be due to HMRC. Mr Khalid also notes that he was subject to Code of Practice 8 enquiries in relation to past years which did not yield tax for HMRC. This is of no relevance to the issue under consideration.

(39) There were 335 transactions for the purchase of soft drinks to which Elbrook was a party over a 30-month period with 3 suppliers all of which were connected with fraud. We find it difficult to accept that such a large number is the result of coincidence.

224. Considering the above, we consider on the balance of probabilities, that Mr Khalid and therefore Elbrook knew that the 335 transactions were connected with fraud.

225. If we are wrong, we consider that Mr Khalid and therefore Elbrook ought to have known that the only reasonable explanation for the circumstances in which the 335 transactions were undertaken was that they were connected with fraud.

226. We dismiss the appeals.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

227. 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.

**HEATHER GETHING
TRIBUNAL JUDGE**

Release date: 28th APRIL 2023