

## **Just Fabulous (UK) Ltd v HM Revenue and Customs [2007] EWHC 521 (Admin)**

**By Philip Woolfe**

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*Just Fabulous (UK) Ltd v HM Revenue and Customs* was one of three cases which were not consolidated but were effectively heard together by the Administrative Court (Burton J), each relating to the powers of HM Revenue and Customs ("HMRC") in relation to so-called "contra-trading" fraud, a variation of MTIC or carousel fraud.

Burton J reviewed the operation of typical MTIC fraud. Goods are sold from one trader to another in a chain of transactions ("the defaulting chain") until one trader exports them from the UK ("the Exporter"). One trader in the chain goes missing without accounting to HMRC for the output tax it has received from those traders it has supplied. However, other traders in the chain recover, or attempt to recover, input tax in respect of their transactions. The net result is that the Revenue suffers a loss equal in amount to the amount of output tax which is taken by the missing trader, albeit that the loss may not crystallise in large part until HMRC gives credit in respect of the input tax which is claimed by the Exporter.

Burton J noted the measures taken by HMRC to reduce the incidence and value of MTIC fraud, which have included the refusal to make payment to the Exporter at the end of a suspect chain of transactions. Burton J emphasised that so-called "contra-trading" fraud is designed to counter such measures on the part of HMRC.

Burton J described the practice of contra-trading. Where HMRC would otherwise refuse to pay a claim for input tax in respect of the goods which have been the subject of the defaulting chain ("the suspect goods"), the Exporter will acquire other goods ("the fresh goods") from another Member State. It will then sell the fresh goods to another trader within the UK ("the Contra-Trader"),

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and in doing so the Exporter incurs a liability to output tax which will, typically more than offset its input tax claim in respect of the suspect goods. As a result, the Exporter does not have to claim a payment of input tax from HMRC. The Contra-Trader will then export the fresh goods out of the UK, and reclaim input tax on that exportation. Since the fresh goods are not themselves part of a suspect VAT chain, the intention is that HMRC will not refuse to pay input tax in respect of their exportation.

The sole live issue in all three appeals was whether it was an error of law for HMRC to investigate and/or refuse the Claimants' entitlement to input VAT where the VAT claimed related to goods which were different from the goods involved in the defaulting chain (i.e. whether HMRC could refuse input tax in respect of the fresh goods).

Burton J treated the matters as being "*effectively a strike-out application by the three Claimants*" to the effect that "*even if the Revenue's case is established, it is unable to take the course of declining to pay the VAT on the contra-trading transactions*". Consequently, he applied the rule that, as with a strike-out application, the facts must be assumed against the Claimants. The effect was that the application was dealt with on the hypothesis that in each case the Exporter was dishonestly involved in the defaulting VAT chain and that the Contra-Trader entered into the contra-trading transaction knowing of, and participating in, the Exporter's dishonest purpose of off-setting its input tax claim in respect of the suspect goods. No such findings of fact were made in any case.

The Claimants argued that the judgment of the European Court of Justice ECJ in Case C-440/04 *Axel Kittel v Belgian State* ("*Kittel*") applied only to transactions within the defaulting chain and to transactions relating to the same goods which were subject to the defaulting chain.<sup>1</sup> Further, the Claimants argued that (i) *Kittel* should not be extended, in order to preserve legal certainty; (ii) extending the application of *Kittel* would enable the Revenue to obtain multiple recovery of its loss in respect of a single MTIC chain by refusing multiple claims for payment of input tax; (iii) to refuse the Contra-Trader's claim for input tax would amount to a penalty without *vires* in European law; and (iv) refusing the Contra-Trader's claim for input tax would not achieve the stated aim of preventing tax evasion, as the fraud and loss have in each case already occurred within the defaulting chain.

HMRC argued that *Kittel* was not expressly limited to transactions within the defaulting chain. Where the taxable person knew or should have known that he was participating in a transaction connected with fraudulent evasion of VAT, a claim for input tax might be refused. Alternatively, it was natural and inevitable to extend the rule in *Kittel*. In response to the points raised by the Claimants, HMRC argued that (i) a fraudulent party could not rely on the argument legal certainty, as he could expect that steps would be taken to defeat his fraudulent ends; (ii) HMRC was not seeking multiple recovery and that ways might be found by the Tribunal or the Courts to prevent multiple recovery; (iii) HMRC was not seeking to impose a penalty, but rather, just as in *Kittel* was exercising a right to refuse repayment of a return apparently in credit due to a fraudulent transaction; (iv) the refusal of input tax in respect of contra-trade transactions was both designed and effective to prevent contra-trading, and thus to prevent typical MTIC fraud.

Burton J stated that he was "*wholly persuaded*" by HMRC's arguments. He considered that the ruling in *Kittel* applied even where the trader is not part of the defaulting chain and even where the goods involved in the transaction are different from those in the defaulting chain. He stated that "*the common system of VAT is much more at risk if firm steps are not taken by the Revenue to prevent the fraudulent abuse of it which, on the assumed facts, would have taken place*". However, he further stated that "*the effect of those principles will need to be worked through, depending on the precise facts, in the slightly different circumstances of a contra-trade chain*". Further, Burton J commented that the problem which had been raised of potential multiple recovery, which would in

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<sup>1</sup> In *Kittel*, the ECJ held that the claim to input tax might be refused where "*the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT*" and that the claim might be refused "*even where the transaction in question meets the objective criteria*" required for a claim for input tax.

effect be the imposition of a penalty, was more likely to arise in contra-trading chain, but might also arise in an ordinary defaulting chain. However, he left the matter to be considered by the VAT Tribunal "*once the facts are known*".

Burton J refused to make a reference to the ECJ on the grounds that the application of *Kittel* was clear, that any further questions of law were best dealt with once the facts of particular cases were known and that any reference might be pointless in the light of such facts.

#### Comment

*Just Fabulous* establishes as a matter of domestic law that the ruling in *Kittel* in principle applies equally to so-called contra-trading chains where knowledge of the fraudulent purpose is established. However, Burton J explicitly left much of the detail to be worked out by the VAT Tribunal in future cases, in particular in relation to the issues of multiple recovery and penalty. Interestingly, he noted that those problems might arise in the context of a more typical MTIC chain as well. Further, he drew attention to the fact that contra-trading chains are at least a "*slightly different*" context, which may be significant when such cases are litigated in detail. He also noted that "*there may well be gradations of knowledge which would need to be considered by the Tribunal*". Where contra-trading chains are involved it may be that such gradations of knowledge will prove to be an even more difficult issue than usual with which to grapple.

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