EMPLOYMENT TRIBUNALS (SCOTLAND)

Case No: S/4113404/15

Held in Glasgow on 27 April 2018

Employment Judge: N Buzzard

Mr Stephen Scott	**Claimant** **In person**
The Richmond Fellowship Scotland	**Respondent** **Represented by:** **Mr D Hay - Advocate**

Judgment

The claimant's claim of unfair dismissal is not founded to be tainted by illegality, and his claim is upheld.

Reasons

1. Background

1.1. This hearing was convened to consider a matter which has been remitted by the EAT. The unfortunate circumstances of the remission are unusual.

1.2. The claimant's claim of unfair dismissal was heard by Employment Judge Paul Cape on 3, 4, 23, 24 May and 4 July 2016. Although a conclusion was reached by Judge Cape, prior to the completion of the written reasons for his

judgment (no oral judgment having been given), for reasons of ill health prior to retirement he was unable to finish the drafting of his reasons.

1.3. The President of the Scottish Employment Tribunals, following correspondence with the parties, promulgated the judgment of Judge Cape, with some typographical corrections and other inserted comments. In addition, the President drafted the judgment part of the decision based on the reasons of Judge Cape. Judge Cape did not address the issue of remedy, which was determined by the President after discussion with the parties regarding the appropriate process to follow.

1.4. An issue in the claimant's claim was whether his contract of employment was tainted with illegality, such that he could not ask the courts to uphold rights derived from that illegal contract. It is recorded by the President in the judgment which was promulgated, as follows:

> *"The reasoning of Employment Judge Cape ends at this point. However he has confirmed in writing that he reached the conclusion that Mr Scott's contract of employment was enforceable"*

1.5. Judge Cape had made extensive findings of fact, appearing to have completed that part of his reasons. These findings of fact appear to cover the relevant findings which were in the mind of Judge Cape when he reached this conclusion, namely that the claimant's contract of employment was enforceable.

2. EAT Decision

2.1. The respondent appealed against the finding that the contract of employment was enforceable.

2.2. The EAT found that the judgement of Judge Cape was not compliant with rule 62(5) of the Employment Tribunal Rules 2013 in relation to the issue of the

illegality (and thus enforceability) of the claimant's contract of employment, due to the lack of reasons for this point. On this basis the EAT upheld the respondent's appeal.

2.3. Further, the EAT concluded that the issue should be determined on the basis of the full facts found by Judge Cape. The issue should be determined by the application of the law to the facts after hearing and considering any submissions of the parties on this issue. Given that there was no need for further fact finding evidence to be heard, the EAT declined to determine the matter themselves, and took the unusual step of remitting the issue to a freshly constituted tribunal to determine.

2.4. In their judgment, the EAT explain that there has been a potential shift in the relevant common law principle as a result of a recent Supreme Court decision on illegality. They go on to explain their concern that the claimant, who was not legally represented, did not appear to have fully understood the significance of the illegality issue to his otherwise successful claim. Lady Wise, at the EAT, concluded that:

> *"I think it is essential, in the interests of justice, that both parties have the benefit of a fully reasoned first instance decision on this important matter, with all subsequent avenues of appeal left open. **

3. Scope of EAT Remission to a Fresh ET

3.1. At the EAT hearing there was clearly some discussion about the appropriate way to proceed. In particular, Lady Wise refers in her reasons to a discussion with the respondent's representative, in these terms:

> *"After discussion at the hearing, Mr Hay for the respondent very fairly accepted both that [remission to a freshly constituted ETj was the appropriate course to take in the unusual circumstances of this case and also that the remit should be restricted so that the full facts shall*

be taken to be as found by Employment Judge P Cape without any opportunity for fresh evidence. "

In accordance with this, the Judgement of the EAT expressly ordered that:

"No new evidence is to be adduced but further submission may be heard. "

3.2. This is taken to be a binding direction of the EAT, to which the respondent is recorded as having expressly consented. This is identified here in detail, as during submissions it became apparent that at least one finding of fact which the respondent sought to rely on was not a matter determined by Judge Cape. Given the scope of the remission, the respondent had to frame their submissions accordingly, despite the relevant factual matters being such that they appeared likely to be easy to determine by mere sight of additional evidence, namely one of the claimant's payslips from the relevant time.

3.3. If this had been found to be an evidential lacuna which had a significant impact on the outcome of the case, this technical procedural limit based on the order of the EAT would have resulted in a clear injustice. As set out below, on application of the updated authority, the determination of this issue was not altered by this lacuna.

4. Issue to be determined

The only issue at this hearing was whether the claimant's contract of employment was tainted by illegality such that he cannot seek legal redress based on that illegal contract.

5. Factual Basis for the decision

As explained above, no evidence was heard and no findings of fact were made at this hearing. The decision is based on the application of the facts found by

Judge Cape at the initial hearing. In that hearing there were two claimants, and multiple issues, which means that not all factual findings are relevant. The relevant factual findings of Judge Cape are as follows (replicating the paragraph numbers of Judge Cape for ease of cross referencing):

9. Immediately prior to dismissal, Mr Scott was employed by the respondent as a Senior Support Worker. At the date of dismissal he had been employed for a little under seven years.

11. The respondent is a charity providing social care throughout Scotland including the provision of domiciliary care and residential respite care.

12. The respondent is headed by a Chief Executive Officer. Beneath him in the structure are five Executive Directors, four of whom have responsibility for a geographical region in Scotland and the fifth is Mr Carroll who is in charge of Finance and Systems, a remit that includes Payroll and Human Resources functions.

13. Beneath the level of Executive Director (insofar as is material to this case) are a number of Area Managers such as Mrs Robertson and Mrs McWilliams, At the tier next below the Area Managers were the Team Managers such as Mrs Scott and, below them, the Senior Support Workers such a Mr Scott. On the first rung of the ladder were Support Workers.

16. Immediately prior to the events resulting in Mr Scott's dismissal, the respondent employed two Senior Support Workers based in Newton Stewarts. Mr Scott was responsible for the domiciliary care side of the respondent's activities. The other Senior Support Worker managed a respite care residential unit The respite care post fell vacant There was, at that time, uncertainty around the continued operation of the respite care unit and there were discussions around that unit passing to the control of the local authority.

17. The future of the respite care unit was discussed between Mrs McWilliam and Mr White. Mrs McWilliam sought the appointment of a Senior Support Worker. Mr White had concerns about budget matters and, in particular, that the Ayrshire part of his command was running at a loss, even though the Galloway part was in surplus.

18. Between Mrs McWilliam and Mr White it was decided that Mr Scott would be asked if he would take on the management of the respite care unit in addition to his existing workload. The respite care unit added substantially to Mr Scott's responsibilities and workload. He was prepared to take on those additional burdens but, entirely understandably, sought additional remuneration to recognise and reward the additional efforts that would be required of him. He could not properly be required to take on the additional work without his consent. If Mr White's plan was to be carried into effect, it was necessary to procure Mr Scott's agreement

19. Mrs Scott, Mrs McWilliam and Mr White were all in agreement that the extra work that Mr Scott was being asked to take on merited increased remuneration.

20. In Mrs McWilliam's presence, Mr White spoke to an HR Business Partner over the telephone. The gist of the conversation was that Mr White wished to increase Mr Scott's remuneration but Mr Scott was at the maximum point of his salary scale so he could not be advanced within the Senior Support Worker pay grade. Subsequently, there was discussion between Mr White and Mrs McWilliam about Mr Scott being promoted to Team Manager level but that came to nothing.

21. There came a time when Mr White presented Mrs McWilliam with a solution to the problem. Mr White proposed that Mr Scott take on management of the respite care unit in addition to his then responsibilities and, in return, Mr Scott would be permitted to claim £250 per month through the respondent's expenses system.

22. Mrs McWilliam informed the claimants of Mr White's decision. Mr Scott gave the matter some thought and concluded that he was prepared to take on the additional burdens of respite care management in return for £250 paid to him through the expenses system.

23. Mr White said nothing to Mrs McWilliam to suggest that he had given any thought to the tax and National Insurance implications of what Mr White proposed. It didn't occur to Mrs McWilliam that any issue arose in respect of tax or National Insurance. Neither did it occur to Mrs Scott or Mr Scott that there was anything untoward in what Mr White had proposed.

24. The arrangement was that Mr Scott would complete an ordinary traveling expenses claim form each month and record on it sufficient journeys from his home in Stranraer to his workplace in Newton Stewart to account for the payment of £250 of travelling expenses. Mr Scott was required to submit the completed form to Mrs Scott as his immediate manager and she was required to countersign the form to approve it for payment

25. None of the arrangement was committed to writing. Ordinarily, the respondent's payroll and Human Resources systems require the completion of forms notifying changes in terms of employment Those forms were not completed in this case. Neither the claimants nor Mrs McWilliam saw anything sinister in that

26. Both Mr Scott in claiming expenses and Mrs Scott in countersigning the form well knew that the expenses being claimed were out-of-the-ordinary in that, ordinarily, journeys recorded on the claim form were from one place of work to another and not from home to the base place of work. The expenses claim form included a declaration signed by Mr Scott that "...the *expenses detailed in this claim for have been incurred by me on the business of [the respondent]"*

27. Whilst Mr Scott knew that the expenses he was claiming were out-of-the- ordinary, he was content that he was entitled to make the claims that he made. Firstly, the arrangement had been proposed by Mr White an Executive Director of the respondent. Secondly, Mr Scott had considerable respect for Mr White and trusted that Mr White was in order in making the proposal that he did. Thirdly, Mr Scott's ordinary commute to work was 25 miles each way, so that, each month he travelled many more miles to and from work than he claimed

for. In countersigning the expenses claims, Mrs Scott knew that the arrangement was one that came from Mr White; she, too, respected and trusted him and she knew of Mr Scott's commuting arrangements.

28. There came a time when Mrs McWilliam told Mrs Scott that Mr Scott should not simply record *"Stranraer to Newton Stewart"* journeys on his claim form but that the journeys should be varied, albeit that the value of the claim was to come to the agreed £250. Mrs McWilliam did not recall this conversation but Mrs Scott did and Mrs McWilliam was clear that it mattered not what was the journey set out on the form, the overriding objective was to record expenses amounting to £250 each month. It occurred to neither claimant to question why the change in recording was put in place. The claimants simply and trustingly went along with what they had been asked to do.

29. In the Spring of 20 15, Mrs McWilliam found work elsewhere and left the respondent's service. By that time, Mr White had also moved on.

30. Before Mrs McWilliam left the respondent's service, she wrote to the claimants by e-mail on 22 May 20 15. The text of that e-mail appears at page 112 of the bundle of productions, The e-mail began*"I'm sending this e-mail as confirmation of Stephens £250 each month additional payment that was agreed with Frank White and myself some time ago.."* The e-mail went on to explain the circumstances which led to the matter being agreed and to confirm it was agreed by the "South *Director and Area Manager".* Mrs McWilliam said that she would include the matter in her handover notes and raise the issue in her final supervision with the then current Executive Director.

43. In the course of his evidence Mr Carroll, a qualified accountant, accepted that it is not unlawful for an employer to agree with an employee that the employee will be paid a sum of money in respect of the employee's home- to-office travelling expenses, albeit that such sums would ordinarily fall liable to be taxed.

44. Following the dismissal of Mr Scott, the respondent adjusted its payroll records to show that the sums paid to the claimant by way of expenses were wages with the result that a tax calculation was carried out The respondent remitted the tax it calculated to be due to the Revenue and purported to render an invoice to Mr Scott The nature or circumstances of the adjustment to payroll were not explained to the Revenue by the respondent

107. What are the material facts? I am satisfied that Mr Scott received the sum of £250 per month from about September 2013 until the termination of his employment and that sum was paid to him as reimbursement of expenses. The respondent reimburses travelling expenses at the rate of 40p per mile, so that the monthly sum represented payment for traveling 625 miles. Mr Scott's ordinary daily commute was a round trip of 50 miles so that his typical monthly home-to-office mileage would amount to in the region of 1000 miles. The proposal put to Mr Scott was that he would be permitted to claim for 625 of those 1000 miles in return for taking on additional work and responsibility.

108. Mr Carroll's evidence was that it is not *per se* unlawful for an employer to agree to pay to an employee travelling expenses incurred in respect of home-to-office travel. Mr Carroll is an accountant and his remit includes being in charge of the respondent's HR and payroll functions.

109. There is no evidence before me to shown that the slightest thought was given to whether income tax and or National Insurance contributions would fall due to be paid on all or any part of the £250 paid each month. I am satisfied that neither Mr Scott, Mrs Scott nor Mrs McWilliam gave any thought to the matter. Mrs McWilliam was able to say that the possible tax implications of the proposed arrangement did not feature in her discussions with Mr White. I have not heard from Mr White whom I find to be the person who proposed the arrangement I am not prepared to infer that the arrangement was intended to avoid the proper payment of tax and or National Insurance, whether by the respondent or Mr Scott Putting the matter at its highest Mr Scott agreed to take on additional work for payment of part of his home-to-office travelling expenses without any thought being given to the tax implications of doing so. It cannot be understated that the arrangement was the proposal of an Executive Director of a substantial professionally managed organisation: such a proposal was not to be viewed with suspicion.

110. I do not attach significance to the change in the way journeys were recorded each month so that Mr Scott ceased to record travel between Stranraer and Newton Stewart and instead recorded purported journeys that came in total to the agreed 625 miles. The change was not instigated by Mr Scott It seems the matter was initiated by Mrs McWilliam. There is no evidence that the change was connected with tax matters and, although Mrs McWilliam was not clear on the point it may be that the change meant that she could more easily allocate the cost to the various cost centres for which she was responsible.

111. Payments in respect of expenses may or may not be liable to income tax. If there is a *"profit"* in what is paid by way of remuneration of expenses in comparison with the expense incurred, that profit is taxable. In respect of traveling expenses, such a profit element is to be found if the rate per mile exceeds that which the Revenue regards as reasonable or if the payment is in respect of home-to-office mileage.

112. I have not been provided with any materials that show when tax should have been paid in respect of the sums paid to Mr Scott. I have taken judicial notice of the system of reporting income to the Revenue as it is known to me as a taxpayer.

113. The Self-Assessment tax return includes a section in which sums received as expenses are to be reported. Mr Scott began receiving the material payments in or about October 20 13. Had he been required to complete a Self-Assessment tax return or requested an assessment form for completion (and I find that neither of those things occurred) the sums received in tax year 20 13/20 14 would have been required to be included in a form submitted not later than 3 1 January 20 15. The sums paid in 20 13/20 14 amounted to £1750 suggesting that the income tax due on those sums amounted to £350. My understanding is that when consideration of a Self-Assessment tax form leads to the identification of a relatively small sum in under-paid tax (and £350 would fall into that category) a Notice of Coding is issued giving a tax code that allows for the recovery of the under-paid tax in the following tax year.

In this case, that would be in tax year 2015/20 16. As I have already set out, the respondent adjusted its payroll so that the whole of the sums paid to Mr Scott was paid in 20 15 (tax year 20 15/20 16), even though, on my analysis, Mr Scott was not due to report the payments in 20 14/20 15 until 31 January 20 16 and the payments in 20 15/20 16 until January 20 17.

6. The Relevant Law

6.1. The relevant law to the issue of illegality is common law. As such, the applicable law is not that which was understood to apply at the date of the relevant acts giving rise to litigation, or that which was understood to apply at the date of the first hearing of this matter. The applicable legal principles that apply are those which are understood to now reflect the common law.

6.2. The only outstanding issue to be determined here is the illegality issue. Put simply the concept of illegality is that a person should not be able to seek the assistance of the courts to enforce an illegal contract, or benefits that derive from an illegal contract. The claimant here seeks to rely on a statutory right, that of unfair dismissal, which is only available to employees. Under the relevant statute (Employment Rights Act 1996), to be an employee you have to work under a contract of employment. Thus, the claimant is seeking to rely on the fact that he has a valid contract of employment.

6.3. It has long been acknowledged that this is a difficult legal principle, which can result in outcomes that do not appear just. In the words of Lord Goff of Chievely in Tinsely v Milligan [1994] 1 AC 340

> *"The principle is not a principle of justice; it is a principle of policy whose application is indiscriminate and so can lead to unfair consequences as between the parties to litigation."*

6.4. The parties were agreed that the law of illegality is one that is not clearly defined, with contradictory decisions that are not always easy to reconcile. Indeed the respondent drew attention to the comments of Professor McBryde in his book 'The Law of Contract in Scotland' (3rd edition):

> *"...there are few topics which have attracted such a wide divergence of judicial approach and judicial difficulty in working out general principles..."*

6.5. The lack of clarity over the relevant law is not one that has caused difficult for the Scottish Judiciary; the problem is one that has taxed the Judiciary in England and Wales for the same reasons.

6.6. That said, submissions from both parties to this litigation, helpfully following written summaries, acknowledge that the relevant area of law is one that has never had a consistent and clear rule of application. This is perhaps unsurprising as it asks members of the Judiciary to potentially hand down decisions that are unjust as a matter of policy.

6.7. As at the date of the initial decision of Judge Cape, the now leading authority of **Patel v Mirza** [2016] UKSC 42 had not been heard. As at the date of the consideration of this case by the EAT this authority was available, and it is the importance of this that, in part, appears to have persuaded the EAT to remit the matter to a fresh first instance tribunal for consideration.

7. The Parties* Submissions

7.1. Both parties handed up detailed written submissions. The respondent relied on those submissions prepared for an earlier hearing in this matter, supplementing them with oral submissions to deal with the more recent authority. The claimant made very few oral submissions of substance, relying on the written submissions which had been prepared for him by a legal adviser.

7.2. The parties' submissions covered broadly the same ground in relation to the state of the current law. This is probably in part because the respondent produced their written submissions prior to an earlier hearing, permitting the

adviser who prepared the written submissions for the claimant the benefit of sight of the respondent's earlier submissions.

8. Submission as to the relevant law pre-Mirza

8.1. Both parties have addressed in some detail the relevant law as it was understood prior to the recent Mirza authority. The claimant's submission did so in reliance on the argument found in **Harvey on Industrial Relations and Employment Law, Division AI, para 76.05(3),** namely that when considering the application of the Mirza authority to employment law cases, it is instructive to consider the authorities specific to employment law albeit in the light of a new consideration of proportionality introduced in **Mirza.** The respondent's submissions regarding the pre-Mirza law were not given an explicit justification, appearing to be provided in order to give context and, therefore, greater understanding to the application of the approach suggested by Mirza.

8.2. Both parties referred to the authority of **Salveson v Simons** [1994] ICR 409 in their written submissions. This is a case which was considered by the EAT, in which an agreement to structure remuneration to avoid tax, which the parties believed (incorrectly) at the time to be legitimate, resulted in the illegality principle preventing a claim of unfair dismissal. Specifically in that case, the fact that the parties were not aware that the arrangement they had reached was illegal was held to be irrelevant. Lord Coulsfield opined in that case that the prima facie position is that, where a claimant is forced to rely on an illegal contract as a basis for a claim, the illegality defence to that claim will apply. The only case Lord Coulsfield could identify where this principle did not apply was Shelley v Paddock [1980] QB348, which was distinguished on the basis that in that case the *"illegality in which the plaintiff was involved paled into insignificance compared with the outright fraud practiced by the defendants".*

8.3. The respondent's submission is that there is nothing in the factual findings of Judge Cape that would support the application of the exception to the prima facie rule as was present in Shelley. On this basis the respondent submits that Salveson is a relevant and applicable authority.

8.4. The claimant submits that Salveson should be properly distinguished, along with a number of other cases referred to by the respondent. These include Daymond v Enterprise South Devon (unreported) and Tomlinson v Dick Evans U Drive Ltd [1978] ICR 639. The respondent cites these authorities as further examples of the principle of illegality applying in an employment law context. The claimant argues that these cases, including Salveson, are of limited assistance, relying for this proposition on the authority of Enfield Technical Services v Payne [2008] ICR30. The relevant comments in this case are from Elias J in the EAT. They were, however, clearly endorsed by Pill LJ on appeal to the Court of Appeal. In Enfield Elias J commented:

> *Tor reasons we have given, in our judgment, there must be some form of misrepresentation, some attempt to conceal the true facts of the relationship, before the contract is rendered illegal for the purposes of a doctrine rooted in public policy."*

8.5. The claimant's submission is that in this case there was no attempt to conceal the true facts of the relationship. Agreement was reached that the claimant would be permitted to claim expenses for mileage incurred (albeit not normally payable under the respondent's expenses policy) up to a maximum of an additional £250 per month. This is what then occurred. The fact that neither party correctly accounted for the tax on these (either the respondent as part of the PAYE system it used to pay the claimant, or the claimant via a declaration to HMRC) is not of itself a misrepresentation by the claimant as to the true facts of the relationship.

8.6. Both parties submitted that the guidance given by Elias J in Enfield is that there are three kinds of illegality cases, as follows:

Category 1 where the contract is entered into with the intention of committing an illegal act;

Category 2 where the contract is expressly prohibited by statute; and

Category 3 where the contract was lawful when made but has been illegally performed, and the party seeking the assistance of the court knowingly participated in the illegal performance.

8.7. The respondent submitted that the current case was a category three case. The claimant agreed with this position in his written submissions. Neither party provides any detailed explanation for this conclusion in their written submissions.

8.8. Given that Judge Cape found that no thought had been given to the payment of taxation at the time of the agreement to vary the claimant's contract of employment, there can be no intent. Further, given there was no thought given by the parties to the tax implications of the agreement and it is clearly not unlawful *per se* to pay expenses for travel from home to a normal place of work (they would, however, be taxable payments); there is nothing in statute which prohibited the agreement reached. Accordingly, the claimant's employment contract was not expressly prohibited by statute. On this basis submissions of the parties that the present case must fall within Elias J's third category muse be correct. The payment of the expenses without proper payment of tax amounts to illegal performance.

8.9. In Enfield, Elias J set out the requirements for an employment contract to meet the test of illegality. The parties' submissions are in agreement, that for an employer to be able to rely on the defence of illegality in a category three case, they will have to show that the employee must have both:

8.9.1 . knowledge of acts (or omissions) which are illegal, and

8.9.2. have participated in the acts which are illegal.

8.10. There is some further discussion within the submissions of the respondent regarding a possible difference in the language adopted in describing types of illegality between **Enfield** and a related Scottish authority. In particular, the respondent referred to the decision of Lord Wheatley in **Dowling & Rutter** v **Abacus Frozen Foods Ltd** 2002 SLT 491, where he categorized the types of illegality as either:

> *"Statutory or at common law; and the illegality may be in the formation of the contract or its implementation."*

The claimant made no specific submission on this point. This different terminology appears not to be different in substance to the categorisation identified in Enfield.

8.11. Participation

8.11.1. The guidance from Enfield is that active participation in the illegality is required, not mere acquiescence.

8.11.2. The respondent submits that the claimant clearly participated in the illegality, having completed expense claims, submitted them, and then accepted the payment that arose from them. This participation continued for a considerable period of time. This time was expressly stated by Judge Cape to be from about September 2013 until the termination of employment in September 2015 (paragraph 107). That being noted, it appears that the payments must in fact have stopped earlier in 2015, namely from when Judge Cape found disciplinary investigations began. Nothing of significance turns on this discrepancy.

8.11.3. The claimant refereed to the authority of **Hall v Woolston Hall Leisure Ltd** [2001] ICR9, where Gibson LJ stated:

> *7f /s a question of fact in each case whether there has been a sufficient degree of participation by the employee.* *

8.1 1.4. The claimant goes on to submit that there was no active participation in the misrepresentation of the expense claims to HMRC. It is submitted that any misrepresentation regarding the claims was intended to do no more than *"get around the respondents internal procedures".* This is consistent with the findings of Judge Cape.

8.11.5. This submission appears to conflate the concept of intent with participation. Whilst he had no intent to deprive the Revenue of tax which was properly due, he cannot be said to have merely acquiesced. He completed a new claim form for each mileage claim made. It appears that this must, on any reasonable analysis, amount to active participation in the acts which were illegal (payment of expenses without tax deduction), although not necessarily with the required knowledge of the illegal acts.

8.12. Knowledge

8.12.1. As to knowledge, the respondent submits that, following **Enfield,** knowledge relates to awareness of the fact of the acts which are illegal, not knowledge that those acts are illegal. Put simply, ignorance of the law is not relevant.

8.12.2. The respondent referred to the comments of Lord Wheatley in **Dowling & Rutter,** who went on to state that the necessary knowledge of the illegality can be *actual* or *constructive.* In the respondent's submission the requirement for knowledge and participation in Enfield are, in practical application, the elements needed to establish the existence of constructive knowledge. If you participate and are aware of facts, that will be sufficient to establish constructive knowledge of any illegality that flows from the acts participated in.

8.12.3. In relation to the claimant's state of knowledge, the respondent submits that the claimant was aware of the illegality as he was in receipt of the payments tax free.

8.12.4. During the hearing the respondent's representative was asked to identify the factual finding in the decision of Judge Cape which showed that the claimant was aware that tax was not actually being paid by the respondent on the relevant expenses.

8.12.5. It was agreed that the payment of expenses for travel to a normal place of work is not *per se* illegal. It is only the failure to pay tax on these expenses that was illegal. This accords with the evidence presented to Judge Cape (paragraph 108).

8.12.6. It was found by Judge Cape that the claimant gave no thought to tax (paragraph 109). There is no clear finding from Judge Cape of how the payments were made to the claimant, other than *"through the expenses system"* (paragraph 22). This does not clarify if the payments were as a distinct tax free sum, part of normal salary via the PAYE system (albeit untaxed) or identified as taxfree on any pay slip. It was further found that although the claimant was aware that the expenses which he was claiming were out of the ordinary (paragraph 26), he believed that he was entitled to make the claims as they were agreed and he did travel more than the claimed miles (paragraph 27), and that (paragraph 109):

> *"It cannot be understated that the arrangement was the proposal of an Executive Director of a substantial professionally managed organisation: such a proposal was not to be viewed with suspicion. "*

8.12.7. Taken together these clearly do not demonstrate a factual finding by Judge Cape that the claimant actually knew that the tax was not being paid on the expenses.

8.12.8. The respondent acknowledged this difficulty. In his written submissions Mr Hay states (the penultimate bullet point in paragraph 18) that *"Mr Scott was aware that this sum was not being subject to deductions for tax.* ", but gives no reference to a factual finding to base this conclusion on. Instead, Mr Hay submitted that the claimant had been promised an extra £250, and then paid an extra £250, rather than £250 less tax, so must have known that no tax was being paid. In effect, the respondent invited an inference that the claimant must have known no tax was being paid.

8.12.9. With the greatest of respect to Mr Hay, that is an assumption, adverse to the claimant, that is not justified. It is clear that the payment via expenses was not normal; it was clear that it was done to avoid the respondent's internal salary scale restrictions; it was further clear that the respondent was a trusted, professional employer operating a full PAYE payroll system. There is no indication that the claimant was not paying tax each month on the majority of his income (albeit not on the relevant £250). Although not clearly stated in the findings of Judge Cape, a proper PAYE system requires the provision of payslips confirming deductions of both tax and NI contributions. An employee in such a circumstance could, and most likely would, legitimately assume that their employer is dealing with any due tax and NI. In the absence of a clear finding to the contrary, it would be improper to infer otherwise.

8.12.10. The mere fact that had the claimant could have, for himself, calculated the amount of tax that he should have paid and check this against what he was told had been deducted by his employer is not an appropriate basis to construct knowledge. Such calculations are not within the capability of the average person and not reasonably expected of any person paid through a professionally run PAYE system with a trusted and respected employer.

8.12.11. For this reason the respondent's submission that the claimant had actual knowledge of the fact that tax was not being paid by the respondent is not accepted.

8.12.12. This leaves the potential of constructive knowledge, as raised by Lord Wheatley. The authorities setting out the test for constructive knowledge agree it is primarily an objective test, that admits differing levels of subjectivity depending on the context of the case. In this case, applying a purely objective test, the claimant did not have constructive knowledge of the illegality. He relied on a professional payroll system of a substantial and trusted employer, as any reasonable employee (save perhaps one employed as a tax accountant) would. Accordingly, the claimant did not have constructive knowledge of the illegality.

8.13. Given the claimant, applying the findings of Judge Cape, did not have knowledge of the illegality, the application of the **Enfield** tests would not permit the respondent to rely on the illegality defence.

9. Submission as to the relevant law post-Mirza

9.1. Both parties referred in their submissions to the authority of Mirza. Whilst the decision of the Supreme Court as to the outcome on the facts of the case in Mirza was unanimous, the analysis in reaching that decision was not.

9.2. The majority view of the court regarding the correct approach to the test of illegality was set out by Lord Toulson JSC. There was significant overlap in the submissions of the parties about the approach of Lord Toulson. In summary, he set out a three stage test to apply, namely that it requires consideration of:

9.2.1. the purpose of the prohibition transgressed and whether that will be enhanced by denial of the claim;

9.2.2. the impact on any other relevant public policy; and

9.2.3. whether denial of the claim would be a proportionate response to the illegality.

9.3. Within that three stage test no prescriptive guidance is given about the factors to be considered, other than (L Toulson - para 120):

> *"Various factors may be relevant, but it would be a mistake to suggest that the court is free to decide a case in an undisciplined way"*

9.4. Lord Toulson went on to suggest some potentially relevant factors as follows:

> *"Potentially relevant factors include the seriousness of the conduct, its centrality to the contract, whether it was intentional and whether there was a marked disparity in the parties' respective culpability".*

9.5. The purpose of the prohibition and whether that will be enhanced by the denial of the claim.

9.5.1. The respondent makes written submissions regarding the importance of upholding relevant tax law. Reference is made to the comments of Sir Raymond Evershed MR in **Napier v National Business Agency Ltd** [1951] 2 All ER 264, that:

> *"There is a strong legal obligation on all citizens to make true and faithful returns for tax purposes. .."*

9.5.2. In addition, reference was made to the statutory obligations in the Taxes Management Act 1970.

9.5.3. The claimant does not seek to submit that the reduction of tax evasion is anything other than a good public policy, instead referring to the state of knowledge of the parties. On the findings of Judge Cape no thought was given to tax. Once the position was clear, the tax was paid by the respondent, not in response to any external agency taking action. On

the claimant's submission it would not be condoning the claimant's illegal contract to allow relief for his unfair dismissal in such a situation, stating *"at worst, it is condoning a simple error, which has been put right."* *(para 5).*

9.5.4. The findings of fact that this decision has to be based upon do not go beyond establishing that the claimant in error did not consider the tax position. The respondent could be viewed as more culpable, being the party who actually dealt with the tax on their payments to the claimant via PAYE. That said, the correction of the error appears to have been at the instigation of the respondent, and the expense of the respondent.

9.5.5. On balance, it is hard to see how the denial of the claimant's claim would have any significant impact on the rules around tax evasion. It has been found to have been an oversight, and the claimant was reasonable in relying on the respondent who was running a PAYE system. Once realised, the tax was paid. Denial of the claim cannot logically discourage errors, and would not reasonably encourage normal employees to check that large trusted employers running a PAYE scheme did so accurately.

9.6. <u>The impact on any other relevant public policy</u>

9.6.1 . The claimant submitted that there was a clear public policy consideration in the upholding of employment rights, given the claimant was unfairly dismissed. The claimant expands on this by asserting that the denial of the claimant's claim would amount to giving the respondent carte blanche to act improperly with no recourse for the claimant, because of an illegality arising from their suggested scheme.

9.6.2. The respondent did not make a specific submission on this point. In relation to the final limb of the Mirza test the respondent did refer to the different approach taken in discrimination cases, it has long been an established principle that the illegality defence will not defeat claims of

discrimination. The respondent's submission was that discrimination provisions are given greater weight in the proportionality balance, (presumably because it was a more important public policy, albeit that was not expressly explained). A submission on this basis must be flawed. The different approach to discrimination cases was based on technical and legal differences between the law of discrimination and unfair dismissal. The Tribunal has not been directed to any authority which suggests that the reason for the difference was because allowing remedy for discrimination was seen as somehow more important for public policy reasons.

9.6.3. As explained above, it is not clear that in the specific circumstances of this case allowing the claimant to enforce his employment rights would adversely impact public policy relating to tax avoidance. The adverse impact on the need for employees to be protected from unfair dismissal would, in this case, be significant. A strict approach would permit employers who made errors when applying a PAYE scheme to their employees, either carelessly or by design, to avoid a substantial range of obligations as an employer.

9.7. <u>whether denial of the claim would be a proportionate response to the illegality</u>

9.8. The claimant submits that the proportionality test means that:

> *'the consequences of allowing the enforcement of the illegal contract must be weighed against the disallowance of the claimant's employment rights. …"*

9.9. The respondent referred to the introduction of proportionality as a consideration, then outlined various factors that would be relevant to the consideration of proportionality. These were the suggested relevant facts of Professor Andrew Burrows in his *Restatement of the English Law of Contract*

(OUP 2016), which were referred to in the judgement of Lord Toulson. These are:

a) how seriously illegal or contrary to public policy the conduct was;

b) whether the party seeking enforcement knew of, or intended, the conduct;

c) how central to the contract or its performance the conduct was;

d) how serious a sanction the denial of enforcement is for the party seeking enforcement;

e) whether denying enforcement will further the purpose of the rule which the conduct has infringed;

f) whether denying enforcement will act as a deterrent to conduct that is illegal or contrary to public policy;

g) whether denying enforcement will ensure that the party seeking enforcement does not profit from the conduct;

h) whether denying enforcement will avoid inconsistency in the law thereby maintaining the integrity of the legal system.

9.10. It is appropriate to observe that Lord Toulson expressly disapproved of the application of a definitive list of factors, stating:

"Professor Burrows' list is helpful but I would not attempt to lay down a prescriptive or definitive list because of the infinite possible variety of cases"

9.11. Noting this, the submissions of the respondent in addressing the list suggested by Professor Burrows are clearly relevant. The submissions of the claimant were more general in terms of proportionality.

9.12. Therefore, the submissions of the parties on the application of the issue are dealt with by reference to the factors suggested.

9.13. *How seriously illegal or contrary to public policy the conduct was?*

This appears not to add anything to the submissions made in relation to the purpose of the enforcement of tax laws discussed above. On balance, this is not found to be a factor that weighs significantly in favour of the respondent.

9.14. *Whether the party seeking enforcement knew of, or intended, the conduct*

9.14.1. Judge Cape makes a clear and explicit finding that the claimant did not even consider tax, which means that, as a logical construction, he could not have intended there to be illegality in relation to tax. Further, as discussed above the claimant did not know of the initial failure to account for the tax by the respondent.

9.14.2. Again, this factor does not weigh in favour of the respondent in this case.

9.15. *How central to the contract or its performance the conduct was?*

9.15.1. The respondent submits that the illegal conduct related to pay, which is fundamental to the contract. The respondent clarified that the portion of pay not taxed was around 15%, which is not a small part of pay overall.

9.15.2. Whilst that may be true, it is noted from the findings of Judge Cape that this untaxed pay was an amendment to an already existing contract, and did not represent a fundamental change to the work/pay agreement reached, albeit there was more work for more pay.

9.15.3. On balance, the change in the contract to agree this additional pay for additional work was clearly ancillary to the pre-existing employment relationship. The parties did not give any thought to tax, from which the only logical conclusion is that the illegal act (non-

payment of tax on the expenses) was not part of the reason for the change. The overall portion of the pay not taxed was a relatively small payment each month, the clear bulk of the payment being a continuation of the pre-existing and wholly legal employment relationship.

9.15.4. On this basis, the illegal act is not found to have been central to the employment relationship.

9.16. *How serious a sanction the denial of enforcement is for the party seeking enforcement?*

9.16.1. The respondent suggests that discrimination claims cannot be defeated by the illegality defence, suggesting that there is a graduation of seriousness in the denial of employment rights. It is the respondent's submission that the denial of unfair dismissal is a less serious sanction.

9.16.2. For the reasons set out earlier, this is not a valid approach to the difference between discrimination and other employment claims.

9.16.3. The claimant submits that the denial of the rights to seek redress for an unfair dismissal is a serious sanction that would give carte blanche to the respondent to benefit from the illegality which arose from their suggested scheme, and for which, as the party responsible for tax in PAYE, they bear greater responsibility.

9.16.4. On balance the claimant's submission on this point is persuasive. The rights of employees are a vital part of modern society, and the protections against unfair dismissal are an important part of those. To permit employers to negate this right by not accounting for tax, when applying a PAYE scheme, on a small part of overall pay, when the

agreement was proposed by a large and trusted employer, would be grossly unfair.

9.17. *Whether denying enforcement will further the purpose of the rule which the conduct has infringed; and*
whether denying enforcement will act as a deterrent to conduct that is illegal or contrary to public policy;

9.17.1. In relation to this factor, as well as the next, the respondent sought to rely on the comments of Sir Raymond Evershed in **Napier,** referred to earlier.

9.17.2. The claimant submits that the illegality was an error, rectified on discovery.

9.17.3. It is difficult to see how allowing the illegality defence in such circumstances could be argued to be a deterrent to the making of errors, or further enforce the purpose of the rule (here reducing tax evasion). Accordingly, despite the comments in Napier regarding the importance of the income being correctly declared for tax purposes, it is hard to see how these factors would weigh in favour of the respondent in this case.

9.18. *Whether denying enforcement will ensure that the party seeking enforcement does not profit from the conduct.*

9.18.1. The respondent on this point merely submitted that it overlapped with the question of centrality, factor (c) in the list provided by Professor Burrows.

9.18.2. The claimant's submission sought to highlight how denial of the right to claim unfair dismissal would, in effect, allow the respondent to profit from the illegal conduct by giving them carte blanch to act as it chooses, with no recourse for the claimant.

9.1 8.3. It is not clear that the claimant has profited from his conduct. He was promised an extra £250, without discussion of tax. Logically that means there was no discussion regarding whether £250 was a gross or net figure. Without evidence that the promised sum was gross, it cannot be said that he has personally gained because he may have believed the offer was net, and the respondent would deal with any additional tax due.

9. 19. *Whether denying enforcement will avoid inconsistency in the law thereby maintaining the integrity of the legal system.*

9.19.1 . The respondent submitted that this was a consideration that was more relevant to analysis of category 1 and category 2 cases as defined in **Enfield,** not a category 3 case as here.

9.19.2. The respondent also referred to the originating principles from the creation of the illegality defence, namely *"no court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act."* (Lord Mansfield, **Holman v Johnson** (1775) 1 Cowp 341).

9.19.3. On balance there does not appear, on the facts of this case, to be any inconsistency on the basis submitted by the respondent. There would be an inconsistency if some employment rights (namely protections against discrimination) could be enforced even with a clearly illegal contract, when other employment rights (here the protection against unfair dismissal) could not be enforced. Whilst this may have been the position pre-Mirza, following the introduction of the consideration of

proportionality as part of the relevant test, this inconsistency has become a relevant consideration. Allowing the defence of illegality to succeed only against some of the key employment rights in the UK would be detrimental to the integrity of the legal system by introducing arbitrary differentials.

10. Summary of Conclusions

10.1. It is important to note that the burden of proof lies on the party seeking to rely on the illegality defence. Here that means the respondent has to prove that the defence applies.

10.2. The findings of fact from Judge Cape do not include a finding that the claimant was actually aware of the non-payment of tax.

10.3. In the circumstances of the case, as found by Judge Cape, it would not be reasonable to expect the claimant to have made the necessary calculations to ensure that the respondent was correctly accounting for the tax in the PAYE system it did apply. Accordingly, the claimant cannot be said to have had constructive knowledge of the failure to account for the tax.

10.4. It follows, that without the required knowledge of the illegal act, which here was the non-payment of tax and not the payment of expenses for journeys between home and work, the illegality defence as understood pre-Mirza cannot assist the respondent.

10.5. It should be noted that this is an unusual case. The referral of this case by the EAT to a fresh tribunal was on the basis that no further evidence should be heard by that tribunal, only submissions. This was expressly stated in the decision of the EAT. This was recorded by the EAT as having been expressly agreed by the respondent, it is very possible that there is evidence that would show the claimant was aware that no tax had been paid (for example it may be stated as such on payslips). Such evidence could not, however,

be relied on by the respondent as it was not within the factual findings of Judge Cape.

10.6. Had there been evidence that the claimant had the necessary knowledge of the illegal act to meet the pre-Mirza test, applying the post-Mirza test, the respondent would still have failed in their attempt to rely on the illegality defence. Whilst due weight is given to the importance of the obligation to correctly pay tax, considering all the factors as explained above it is clear that it would be disproportionate to allow the defence of illegality to defeat the claimant's claim in this case.

10.7. Accordingly, the claimant's claim of unfair dismissal is well founded and succeeds.

Employment Judge: **N Buzzard**
Date of Judgment: **23 May 2018**
Entered in register: **29 May 2018**
and copied to parties