EMPLOYMENT TRIBUNALS

Heard at: Croydon (by video) **On:** 7 March 2023

Claimant: Mr Graham Kempster

Respondent: (1) The REC Horsham Limited

(2) Mr Nicholas McDowell

Before: Employment Judge E Fowell

Mrs S Dengate

Mr S Moules

Representation:

Claimant Ms Kim Nicol, Consultant

Respondent Mr Nicolas McDowell, Director

JUDGMENT

1. The complaint of discrimination on grounds of disability is dismissed on withdrawal.

2. The remaining complaints are dismissed on grounds of illegality

REASONS

Introduction

3. Mr Kempster worked for the company as a Director until his resignation on 24 January 2022. This followed a period of about a year during which he was signed off sick and the submission of a lengthy grievance. Because of his poor health the company responded to his grievance in writing on 5 January 2022 and he resigned in response to this outcome shortly afterwards.

4. The background to this grievance was a falling out between Mr Kempster and the

other directors, principally Mr McDowell, who attended this hearing on behalf of the company and also in his own right as the second respondent. Although the company has been represented by solicitors throughout these proceedings, its financial position is now changed and they are about to enter voluntary liquidation. A liquidator has been appointed and we saw evidence to the effect that the liquidation proceedings have been held up only by a lack of contact with one of the other directors, Mr Stuart Green.

5. There are two claim forms in this case. The first was submitted on 25 May 2021 and brought claims in respect of outstanding wages and other payments. There was then a second claim form on 8 March 2022 which also brought claims of disability discrimination, constructive dismissal, automatically unfair dismissal and detriments for making a protected disclosure and other money claims.

6. These two claim forms were then considered at a preliminary hearing on 18 November 2022 and consolidated. The protected disclosure in question relates to the grievance and although this was a long and detailed document raising a number of issues, the main points of concern were the failure to properly account for the earnings received by Mr Kempster during his employment with the company and abuse of the furlough system. He says that not only was he placed on furlough at the beginning of the first national lockdown and paid £2500 per month net, but Mr McDowell did the same for himself and also for his wife Ms Rebecca McDowell.

7. Both of these allegations involve serious wrongdoing. Although not addressed by other party in their respective statements of case, we identified at an early stage of this hearing that the possible defence of illegality was open to the respondents. Mr Kempster was a director of the business throughout and arguably lent himself to these arrangements. In those circumstances we decided to deal with this aspect as a preliminary issue and hear evidence from each side as to the employment arrangements, the tax and national insurance position, and the use made of the furlough scheme. We then heard that evidence and submissions on each side so this issue alone occupied much of the second day of the hearing, the first having been given over to reading. Having done so, we make the following findings of fact.

Findings of Fact

8. The RTC Horsham Limited is a leisure centre in the town with a bowling alley upstairs and a sports bar downstairs which also serves meals. It was an existing business which was taken over by the three directors in question in March 2018 . Mr Kempster had been working as an employee at a similar business, in which Mr McDowell had an interest, and agreed at Mr McDowell's request to invest in this new venture. The circumstances in which they took over the business never became clear but there was an existing workforce of between 10 and 20 staff members who were paid through a payroll . Mr Kempster invested £18,000. Mr McDowell put in £50,000 pounds, as did Mr Green, who is an experienced director in the pub and leisure

industry.

9. There is a noticeable absence of any documentary evidence about what the three men agreed about their remuneration and their roles within the business. All we have is a few WhatsApp messages which were condensed onto one page and cover the period from 13 to 15 March 2018. These indicate that Mr Kempster was happy to start working the business straight away as long as he received the same money he was previously on. His evidence to us that was that he was expecting £2000 per month net to meet his outgoings.

10. No figures were set out in those messages, or anywhere else, and no contract of employment was ever raised. It was a purely oral agreement. Mr Kempster has set out his view of what was agreed in a number of different ways. In his first claim form (at page 32 of the bundle) he says that it was agreed at the outset that he would be paid £2000 per month net from 29 March 2018, together with pension contributions, and hence the total amount should have been £31,432 per annum gross. In his witness statement for this hearing he put forward the figure of £35,000 pounds as the agreed annual salary (paragraph 53). Hence, he states, "I was to be paid £2,350 per month net (£2,500 gross) which I was advised by Nick, as an accountant, was correct." However, those gross and net figures do not correspond and the tax and national insurance due for a net figure of £2350 increase the total to considerably more. Mr Kempster also says that they agreed at this initial meeting in March 2018 that his salary would then increase to £40,000 per year from the beginning of the next financial year, i.e. from April 2019. Once again come with that figure is not recorded in those messages or anywhere else.

11. Mr Kempster has however provided a helpful table setting out the payments which he actually received from then on. It shows that during 2018 he received various sums, beginning with an initial payment of £2,265 in April. That then dropped to £1,900 in early June, returned to £2,265 in early July, and after that there were monthly variable amounts, some as low as £450. By September the total had amounted to £11,230, which is a figure which appears on a set of monthly management accounts for September 2018 under the heading "directors' remuneration". It is not disputed that Mr Kempster had access to those monthly management accounts and that should have confirmed to him that all of the directors' remuneration declared was being paid to him.

12. The relevant half-yearly budget figure in the next column was £15,000, indicating that the company had budgeted to pay him £30,000 in total for the year. It should also have been clear however that no tax had been paid on the sums paid since that was the total cost to the business.

13. Reviewing this evidence our conclusion is that the agreement between the parties was that Mr Kempster would be working in the business on a full time basis, directing the staff, and so ought to have been treated as an employee from the outset.

However, it was recognised that the business might not be able to support this outlay from the beginning and so he would be simply to be paid about £2000 per month, depending on the bank balance, until the finances were in a stronger position. In the meantime no tax or national insurance would be paid. The company have since accepted as a result of Mr Kempster's grievance that he ought to have been treated as an employee from the outset, although this admission follows the disclosure of what we regard as serious wrongdoing on their part and the prospect of this hearing at which it would be considered. Their case is that they have now accounted to HMRC for all sums due but, as we shall see, the amounts contributed still fall short of what would have been payable if Mr Kempster had indeed received an agreed salary of 30,000 or £35,000.

14. No pay slips were provided to Mr Kempster during this period. Mr McDowell says that he had access to them on the computer system, and if he could not see them then he only had to ask. Given later events, when there was a clear degree of concealment, we prefer the view that he was not able to see them, but equally there is no documentary evidence of any complaint or enquiry on his part.

15. Pay slips began to be raised in February 2019, although Mr Kempster was not aware of them. Over March and February 2019 the totals recorded on those payslips amounted to £5000.01. These documents were simply a fiction, and the sums in question were never paid into his bank account. This was, we conclude, an attempt by the company, and Mr McDowell in particular, to present HMRC with the false picture that this new company was now starting to earn money and for the first time to pay wages to its working director.

16. That is consistent with other developments at that time. In January 2019 (page 241) Mr McDowell informed Mr Kempster and Mr Green by e-mail that from now on they would move away from paying Mr Kempster £2350 per month (although that figure was only paid occasionally) and they would all be on a minimum salary of £11,850 plus a division of profits. That figure of £11,850 was the personal allowance for income tax at the time. Clearly there was a tax advantage in directors receiving as much of their pay as possible in the form of dividends or a division of profit and ascribing as little as possible to salary, on which tax and national insurance would be due. It would also make it more difficult for HMRC to challenge the payment structure. The payment of £5000 paid to Mr Kempster in 2018/19 can therefore be seen as a staging post on the way to a figure of £11,850 the following year.

17. Like much of the evidence we heard and have seen, it is difficult to make clear sense of these arrangements. All three directors were in very different positions. Mr Kempster was working full time in the business. It seems that at some stage during 2019 Mr McDowell became increasingly involved in the day-to-day operation of the business, whereas Mr Green never did so and for large periods was uncontactable. There is no obvious basis therefore on which Mr Green would receive a salary of £11,850 or why they were all to be treated in the same way from that point onwards.

It may well be that this e-mail was in fact simply directed at Mr Kempster and sent to Mr Green for his information.

18. However, this tentative arrangement did not come into effect. Mr McDowell, who managed the company's accounts and is an accountant by training, continued to issue pay slips recording that sums were being paid to Mr Kempster although in fact no payments whatever were received by him after March 2019 for over a year. Mr Kempster carried on from month to month, hoping for some payment. Meanwhile the pay slips record various sums being paid to him, totalling just £7,500 that year. It is not clear why the full £11,850 tax allowance was not utilised, unless the company was in very poor health.

19. We found it very difficult to accept that Mr Kempster could have managed in this way for such a long period but he assured us that he is an exceptionally frugal individual and ran up large debts on his credit card. From his point of view he was confident that the business would succeed, he had left a previous job where he was well paid and was committed to the project, so he thought there was no turning back. More remarkably still perhaps, there is no record via any e-mail or WhatsApp message from Mr Kempster to Mr McDowell during this period querying his pay, asking when he could expect to receive any, how much it might be or even why it had stopped. Since these facts are undisputed we have to accept them.

20. However hard the financial position was for Mr Kempster during this period, this silence on his part, and the continuing lack of any clarity or documentation about his entitlements, is difficult to reconcile with the claim that he was an employee on an agreed salary (by then) of £40,000 per year. Again, it is unclear what, if anything was agreed for that year. The email at page 241 proposing a salary of £11,850 is a fairly clear proposal, but there was no response to it, and it was not acted on, even to the extent of supporting it with bogus payslips up to that amount. The respondent's position is that they have since accounted to HMRC for all sums due, but it is not clear to us how those sums have been assessed.

21. Mr McDowell's evidence was that they were unable to pay him any money during this period in 2019 because trading was poor, but that Mr Kempster was accruing an entitlement to be paid in due course and all parties were content with that arrangement. There is some support for that in an e-mail from Mr McDowell to Mr Kempster on 4 February 2020 (page 306) although it is very difficult to follow, and Mr McDowell said that he was unable to explain it after this lapse of time. It sets out a figure for payments made between 27 April 2018 and 7 March 2019 of £26,880, although that does match the total paid. It then says that £6,790 was processed via payroll between February and September 2019, although in fact no payments were made that year after March. (This is at least evidence that Mr Kempster knew that sums were being attributed to him through the payroll system.) The next figure is £20,458.88, described as "net pay to be processed via Feb payroll". However that amount is then subject to various deductions including director's loan payments and

expenses which reduced it to a small sum - no final figure was confirmed.

22. Again, it is very difficult for us to understand why this sort of e-mail did not lead to conversations between Mr Kempster and Mr McDowell as to what the business could afford, especially when once again at the end of February no payments were made to him. He was a director of the business who had not seen any pay slips for his own remuneration for two years at this point, and was being told about sums going through the payroll, so he might have been expected to make further enquiries.

23. This was of course only a short period before the first national lockdown which began on 23 March 2020. In his grievance, Mr Kempster complains that in the run up to the introduction of the furlough scheme, Mr McDowell placed himself on the company payroll together with his wife Ms Rebecca McDowell who was by then also doing some work within the business. There is a table of such payments at page 458 which was not disputed. It shows that Mr Kempster received £2,500 net per month from April to June 2020, increasing for the next four months to £2,954 pounds. Meanwhile Ms McDowell also began to receive £2,500 pounds, increasing to £4,084 pounds in September 2020. Mr McDowell himself also received £2500 in wages in April 2020.

24. It is understandable that Mr Kempster would complain about the sudden use of the furlough scheme to pay what appear to be new sums of this sort to Mr and Mrs McDowell. We also have to note however that his payment of £2,500 in April 2020 was the first sum he had received for over a year and so he could not properly have concluded that this was compensation for sums he would otherwise have received in the normal course of events.

25. Mr Kempster also complained in his grievance that Mr McDowell was working in the business throughout this period when he was receiving furlough pay, but it is clear that he too was also involved, despite being furloughed. His case is that he was just doing director-level jobs in April and May 2020, not the sort of operational duties which he had been doing, and that the business reopened in June in part, at which point he thought that the salary he was receiving was not supported by the furlough scheme. However in his grievance (page 594) he stated:

> It appears that Nick took the decision unilaterally to place me on furlough from mid-March 2020. I did not consent to this and did not sign a written agreement as required under the relevant legislation. Accordingly, I do not accept that I was furloughed and require payment in full for March through to June 2020.
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> I was working for the company during this period (as were Becca and Nick). I was asked to produce marketing budgets and forecasts and business plans. From the end of May 2020, I was supervising/managing work on the kiosk and I worked shifts when the kiosk opened on 13 June 2020 (as did Nick and Becca). As indicated above, I require payment for this period.

26. The suggestion in the first paragraph above is that he regarded this £2,500 as only

80% of his proper pay, but again that ignores the reality of a previous year with no pay and no clear agreed figure for his salary.

27. Mr Kempster told us that he did not receive any pay slips at all until he obtained access to the payroll system in November 2020 and was then able to see what had been paid on his behalf. Hence, as a director of the business, he says that he worked full time within it for a period of about 2 ½ years without receiving any pay slips and without raising any query about whether the company was accounting for tax or national insurance on his receipts, although we recognise that for nearly a year of this period he was not receiving anything at all.

28. The relationship between him and Mr McDowell broke down during the summer and autumn of 2020 and there were a number of disagreements about how things were being run, including compliance with social distancing regulations and the like. During this period Mr Kempster discovered how much Mr McDonnell had been receiving from the business while he had gone unpaid. The statutory accounts for the period ending 31st March 2020 show that during this very difficult period Mr McDowell had charged the company a consultancy fee of £68,880. That was for his work in the business. Mr McDowell accepts that he did not tell Mr Kempster about this payment or payments and no reference to it appears in any of the monthly management accounts. It is only referred to in this footnote to the statutory accounts. We cannot see any circumstances in which a director of a business is justified in approving for himself such payments without disclosing it to his fellow directors and indeed it appears to be a clear breach of the shareholder's agreement. Mr Kempster was understandably amazed and appalled.

29. Those then are the key facts on the question of the tax issue and potential abuse of the furlough system.

Applicable Law

30. It is well established that a contract may be legal at its inception but become illegal because of the way in which it is performed - usually, in an employment context, by a failure to pay tax and national insurance contributions. For many years the traditional approach was that set out by HHJ McMullen QC in **Quashie v Stringfellow Restaurants Ltd (UKEAT/0289/11)**

> "The claimant who seeks the protection of the Employment Tribunal in the enforcement of her rights against the respondent should pay the taxes properly due upon the earnings which themselves support the administration of the Tribunal system.
>
> If she is not paying her way, why should she be entitled to free access to the administration of justice?"

31. That followed the case of **Hall v Woolston Hall Leisure Ltd [2001] 1 WLR 225,** in which the claimant was employed as a chef in a golf club but was dismissed when

she told her employer that she was pregnant. The employer argued that she was not entitled to compensation because it had not been paying the proper amount of tax on her salary. She had queried her pay when she discovered that her payslips differed from the money she received each week but had simply been told that that was the way the club did business. In those circumstances the Tribunal concluded that the contract was illegal and unenforceable because she had continued to work in the knowledge that her employer was defrauding the Revenue. The Employment Appeal Tribunal agreed. The Court of Appeal overturned that decision however and held that in discrimination claims, given the need to apply the equal treatment directive national law should be interpreted so as to give effect to it in circumstances where there was no causal link between her wages and the sex discrimination. That was therefore a relaxation of what had previously been a fairly strict rule about enforcement and one made in the context of a discrimination claim.

32. This principle was recently considered by the Supreme Court in the case of **Patel v Mirza 2017 AC 467, SC** and we referred the parties to this guidance at the outset of this issue. It was not a case in the employment field. It involved insider trading and an agreement by Mr Patel to pay £630,000 to Mr Mirza to make use of that inside information by gambling on the stock market in RBS shares. If the strict doctrine of illegality applied with full force, Mr Patel could not have got his money back, and Mr Mirza would have had a windfall of £630,000 despite being equally culpable.

33. The Court held that in cases where illegality was an issue, the key question was not whether the contract should be regarded as tainted by illegality but whether, in the circumstances of the case, the relief claimed should be granted.

34. The essential rationale of the illegality doctrine, according to Lord Toulson, is that it would be contrary to the public interest to enforce a claim if to do so would harm the integrity of the legal system (or, possibly, certain aspects of public morality). In assessing whether allowing a claim would harm the integrity of the legal system, his Lordship stated that it would be necessary to consider:

    (a) the underlying purpose of the law that had been breached, and whether that purpose would be enhanced by the claim being refused

    (b) any other relevant public policy which might be affected by the denial of the claim, and

    (c) whether denial of the claim would be a proportionate response to the illegality (bearing in mind that punishment is a matter for the criminal courts).

35. On the question of proportionality Lord Toulson held that a number of factors could be relevant including:

    (a) the seriousness of the illegal conduct

(b) its centrality to the contract

(c) whether it was intentional, and

(d) whether there was a marked disparity in the parties' respective culpability.

36. Both Patel and Hall were also considered quite recently by the Court of Appeal in **Okedina v Chikale [2019] IRLR 905**, a case in the immigration context, where the contract was illegal because the employer had not sorted out the claimants visa. That case was then considered by the Court of Appeal again in Robinson and concluded that the "knowledge plus participation" test, long established in **Hall**, represents a necessary but not a sufficient criterion for the defence of illegality to succeed. In other words, knowing the tax was not being paid and going along with it were not enough by themselves.

37. The Court of Appeal revisited this question in **Robinson v Al-Qasimi 2021 ICR 1533, CA,** in the context of an illegality defence to claims of wrongful and unfair dismissal. It is a case which is closer on the facts to the present one. In that case Ms Robinson began working for the respondent in 2007 on the basis that she would be paid £34,000 per year and would be responsible for her own tax and national insurance. In 2014, after seven years of this, she asserted that the terms of the contract were that she would be paid net of tax and that it was for the company to pay the tax. They disagreed and from then on began to withhold tax from the payments. She accepted the position and continued working for them for the next three years before bringing a claim under the whistle blowing legislation.

38. As already noted, the Court of Appeal found that going along with an underpayment of tax in this way was not by itself sufficient to prevent her enforcing the agreement. The tribunal also needs to take into account such matters as the degree of participation, the seriousness of the illegality and the proximity of the illegality to the claim. There had to be an overall assessment of whether denial of the claim would be a proportionate response to the illegality having regard to the three conclusions set out in **Patel**. The court also drew a distinction between this sort of situation and **Hall**. In **Hall**, the claimant was described as being an accessory, i.e. the main fault was on the part of her employer. Here, she was regarded as the principal, and so she was not allowed to pursue her whistleblowing and other claims.

39. There are a number of features of Mr Kempster's case which are perhaps even more marked than in **Robinson**. Firstly Mr Kempster's employment status was far from clear. We accept and agree that he ought to have been regarded as an employee from the outset and that is the conclusion that the respondent ultimately came to following reports to HMRC and Mr Kempster's grievance. However considerable weight has to be given to the fact that he was a director of the business and was the only director working in the business on a full time basis throughout. He was responsible for HR and recruitment so it is surprising to us that he was so unfamiliar

with the company's finances at every point. And he was a director for two and a half years before insisting on having sight of any pay slip in his name or apparently making any query about that. We have to regard him as having been complicit in these arrangements, if only by his inactivity over such a long period. He was not a mere accessory.

40. The second aggravating feature is that there appears to have been a clear abuse of the furlough system, with Mrs McDowell and Mr McDowell joining the payroll shortly before furlough payments were made. But again, this applied equally to Mr Kempster. He might consider that he had a much better claim than them to be receiving salary payments from the company but we cannot see that any salary figure was in fact agreed. In those circumstances it may well be that no contract was ever entered into, on the basis that the terms were too uncertain. We feel we do not have to resolve that issue. Suffice to say that we are satisfied that he ought to have been regarded as an employee from the outset and that this key issue ought to have been agreed. On any basis he was a worker and any payments made to him ought to have had appropriate deductions for tax and national insurance, and the proper procedure for being furloughed should being followed. It is difficult to understand how he too was furloughed at such a high level of salary given the amounts being declared to HMRC in respect of his earnings. Again we conclude that he must have been complicit to a degree in this arrangement and it is not simply acceptable to say that he left it all to Mr McDowell and assumed that everything was in order. The same applies to the fact that he continued to carry on doing some work in the business during this time.

41. We return to the guiding principles from Patel therefore, to ensure that we have applied the correct principles.:

    (a) Firstly, the underlying purpose of the law that had been breached was the usual purpose of the tax and national insurance system - to make sure that a fair contribution is levied from individuals and businesses to support public services. To that has to be added the purpose of the furlough scheme to provide an appropriate level of support to businesses which would otherwise not survive the coronavirus pandemic . It was not to provide a windfall to such businesses, particularly in circumstances where those businesses were not abiding by their obligations to account for tax and National Insurance

    (b) Secondly there is the question of whether those purpose would be enhanced by the claim being refused. This is not a decisive question but there is clearly a strong public interest in upholding those purposes and a corresponding loss of confidence by the public in courts and tribunals which do not seek to uphold them. This is not, or at least is no longer, a discrimination claim and so the public policy on ensuring equal treatment no longer applies. There is a public interest in whistle blowing allegations being heard and considered but the effect of that consideration is limited here since the disclosures in question were

mainly about illegal actions by Mr McDowell in which we find, to a much lesser degree, Mr Kempster was complicit. The illegality in question is central to the whistleblowing allegations and to the claim of constructive dismissal. The grievance essentially arose in the context of a breakdown in the relationship between the two of them. Although this was in part because it became clear that there had been a very unequal division of the spoils of the business, particularly the large and undeclared consultancy fees, it also related to the use made by Mr and Mrs McDowell of the furlough scheme.

(c) Thirdly there is the important question of whether or not denying the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts. This is clearly a difficult question to apply. We have not been able to locate any similar case in which a claim has been allowed to proceed and for the reasons already given it is significantly more serious than that in **Hall** or **Robinson**. We have regard to the disparity between the rewards taken by Mr McDowell and that paid to Mr Kempster although we conclude that that should not be sufficient reason by itself to overlook such a sustained lack of regard to his obligations to account for tax and national insurance. It is of course open to a party to make enquiries online about their tax affairs and to check whether their national insurance payments are being made. Mr Kempster turned a blind eye to this whole issue, and we have to conclude that that failure was deliberate. The final question of whether there was a marked disparity in the parties' respective culpability is not intended to involve a comparison between Mr Kempster and Mr McDowell - although there is a significant difference in their relative culpability - it is about the difference between Mr Kempster's responsibility and that of the respondent company, of which he was a director. In those circumstances it seems to us wrong to allow our indignation at the way he was treated, particularly during 2019 when he received no pay, to obscure our view of the test we have to apply. The fact is that he retained a considerable responsibility for these tax and furlough arrangements.

42. Accordingly we conclude that the complaints have to be dismissed. There is no longer any basis to distinguish between the various complaints brought. The complaint of constructive dismissal and automatically unfair dismissal both arise out of the contract of employment. They are both claims of unfair dismissal contrary to section 94 Employment Rights Act 1996 . Nor is there any basis to distinguish between the complaints of whistle blowing detriment and dismissal and so it follows that those claims to have to be dismissed against the company and against Mr McDowell personally. The same applies in respect of the remaining money claims which are contractual.

43. This is an area where a decision has to be made one way or the other which may appear particularly harsh to one party and generous to another. As noted by Lord

Toulson in **Patel** at paragraph 106:

> 106. In Saunders v Edwards [1987] 1 WLR 1116, 1134, Bingham LJ said
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> "Where issues of illegality are raised, the courts have (as it seems to me) to steer a middle course between two unacceptable positions. On the one hand it is unacceptable that any court of law should aid or lend its authority to a party seeking to pursue or enforce an object or agreement which the law prohibits. On the other hand, it is unacceptable that the court should, on the first indication of unlawfulness affecting any aspect of a transaction, draw up its skirts and refuse all assistance to the plaintiff, no matter how serious his loss nor how disproportionate his loss to the unlawfulness of his conduct."

44. We find here that the loss is not so disproportionate, and that it would undermine the purpose of the tax system and furlough arrangements to waving through the conduct in question, even though Mr McDowell had the major responsibility for the breaches in question.

Employment Judge Fowell

Date 08 March 2023

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