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*Judgment: approved by the Court for handing down* | *Delivered:* **14/01/2016**
*(subject to editorial corrections)**

**IN HER MAJESTY'S COURT OF APPEAL IN NORTHERN IRELAND**

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**ON APPEAL FROM THE OFFICE OF INDUSTRIAL TRIBUNAL AND THE FAIR EMPLOYMENT TRIBUNAL**

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**BETWEEN:**

**THE DEPARTMENT FOR EMPLOYMENT AND LEARNING**

**Appellant**

**-and-**

**RICHARD JAMES MORGAN**

**Respondent/Claimant**

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**Gillen LJ Weatherup LJ and Weir LJ**

**WEATHERUP LJ (delivering the judgment of the Court)**

[1] This is an appeal from decisions of the Industrial Tribunal dated 24 January 2014 and on review dated 20 August 2014 finding the respondent/claimant to be an "employee" for the purposes of Article 3 of the Employment Rights (Northern Ireland) Order 1996. Mr McGleenan QC and Mr Potter appeared for the appellant and Mr McKee for the respondent/claimant. The Court is grateful to the Pro Bono Unit of the Employment Lawyers Group and to Brian McKee instructed by Millar McCall Wylie, solicitors, who provided their services to the respondent/claimant for the purposes of this appeal.

[2] This is a further instance of a director and shareholder of a limited company also claiming employee status. For ease of reference Mr Morgan will be described as the claimant. Further to the finding that the claimant was an employee the Tribunal confirmed his entitlement to a redundancy payment of £9,460, notice pay of £5,160, holiday pay of £2,150 and arrears of pay of £267.31.

The Employment Rights (Northern Ireland) Order 1996.

[3] The 1996 Order provides that where an employer is insolvent and an employee claims that the employer is liable to pay to him redundancy payment (under Article 201) or holiday pay, notice pay or arrears of pay (under Article 227) then the amount of the debt is payable by the Department.

[4] Article 3 of the 1996 Order provides:

> "(1) In this Order 'employee' means an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract of employment.
>
> (2) In this Order 'contract of employment' means a contract of service or apprenticeship, whether express or implied, and (if it is express) whether oral or in writing."

The approach to determining whether a person is an employee.

[5] This Court had occasion to consider the issue of whether a person was the "employee" for the purposes of the 1996 Order in Crawford and Dunlop v Department of Employment and Learning [2014] NICA 26. At paragraph [11] of the judgment this Court referred to the operation of the equivalent statutory scheme in Great Britain, as considered by the Court of Appeal in England and Wales in Neufeld & Anor v Secretary of State [2009] EWCA Civ 280. In the course of that judgment Rimer LJ adopted guidance to Tribunals formulated by Elias J in Clark v Clark Construction Initiatives [2008] IRLR 364 and added comments on some of the aspects of that guidance. Set out below is the guidance and in italics the comments.

> How should a tribunal approach the task of determining whether the contract of employment should be given effect or not? We would suggest that a consideration of the following factors, whilst not exhaustive, may be of assistance:
>
> (1) Where there is a contract ostensibly in place, the onus is on the party seeking to deny its effect to satisfy the court that it is not what it appears to be. This is particularly so where the individual has paid tax and national insurance as an employee: he has on the face of it earned the right to take advantage of the benefits which employees may derive from such payments.

*In cases where the putative employee is asserting the existence of an employment contract it will be for him to prove it and as we have indicated the mere production of what purports to be a written service agreement may by itself be insufficient to prove the case sought to be made. If the putative employee's assertion is challenged the court or tribunal will need to be satisfied that the document is a true reflection of the claimed employment relationship for which purpose it will be relevant to know what the parties had done under it. The putative employee may therefore have to do rather more than simply produce the contract itself or else a board minute or memorandum purporting to record his employment.*

(2) The mere fact that the individual has a controlling shareholding does not of itself prevent a contract of employment arising. Nor does the fact that he is in practice able to exercise real or sole control over what the company does.

(3) Similarly, the fact that he is an entrepreneur, or has built the company up, or will profit from its success, will not be factors militating against a finding that there is a contract in place. Indeed, any controlling shareholder will inevitably benefit from the company's success, as will many employees with share option schemes.

(4) If the conduct of the parties is in accordance with the contract, that would be a strong pointer towards the contract being valid and binding. For example, this would be so if the individual works the hours stipulated or does not take more than the stipulated holidays.

(5) Conversely, if the conduct of the parties is either inconsistent with the contract [acting in a manner which suggests the contract is being set at nought or is treated as no more than an irrelevant piece of paper] or in certain key areas where one might expect it to be governed by the contract is in fact not so governed, that would be a factor, and potentially a very important one, militating against a finding that the controlling shareholder is in reality an employee.

(6) In that context, the assertion that there is a genuine contract will be undermined if the terms have not been identified or reduced into writing. This will be powerful evidence that the contract was not really intended to regulate the relationship in any way.

*It may perhaps have put a little too high the potentially negative effect of the terms of the contract not having been reduced to writing. This will obviously be an important consideration but if the parties' conduct under the claimed contract points convincingly to the conclusion that there was a true contract of employment we would not wish tribunals to seize too readily on the absence of a written agreement as justifying the rejection of the claim.*

(7) The fact that the individual takes loans from the company or guarantees its debts could exceptionally have some relevance in analysing the true nature of the relationship, but in most cases such factors are unlikely to carry any weight. There is nothing intrinsically inconsistent in a person who is an employee doing these things. Indeed, in many small companies it will be necessary for the controlling shareholder personally to give bank guarantees precisely because the company assets are small and no funding will be forthcoming without them. It would wholly undermine the approach [in Lee v Lee's Air Farming [1961] AC 12] if this were to be sufficient to deny the controlling shareholder the right to enter into a contract of employment.

(8) Although the courts have said that the fact of there being a controlling shareholding is always relevant and may be decisive, that does not mean that that fact alone will ever justify a tribunal in finding that there was no contract in place. That would be to apply the test [in Buchan and Ivey v Secretary of State for Employment [1997] IRLR 80] which has been decisively rejected. The fact that there is a controlling shareholding is what may raise doubts as to whether that individual is truly an employee, but of itself that fact alone does not resolve these doubts one way or another.

*The Court of Appeal commented on the seventh and eighth factors that 'never say never' is a wise judicial maxim. In that regard the Court of Appeal stated that "ordinarily" a claim to be an employee of the company would not be defeated by a shareholding that gave control of the company, by share capital invested in the company, by loans made to the company, by personal guarantees of the company obligations, by personal investment in the company by which the claimed employee stands to prosper in line with the company's prosperity nor any of the other things that the owner of a business would commonly do on its behalf. These considerations are usual features of the sort of companies giving rise to the type of issues with which these appeals are concerned but they will ordinarily be irrelevant to whether or not a valid contract of employment has been created and so they can and should be ignored.*

[6] In Crawford and Dunlop the Court concluded that the Industrial Tribunal had not made a full enquiry and the appeals were remitted to the Industrial Tribunal for further enquiry as to the circumstances of the relationship between the claimants and the company. For the purposes of that exercise a schedule was prepared and annexed to the judgment setting out the potential scope of the Tribunal's enquiry. The particulars contained in that schedule were relevant to the particular case and may be relevant to an enquiry on the same subject undertaken by other Tribunals.

The original and review decisions of the Tribunal

[7] The findings of fact made by the Tribunal were as follows –

(4) The claimant was born on 20 April 1967. He was employed by Saville Tractors (Belfast) Limited on 20 November 1989 as a management accountant under a contract of employment.

(5) Saville Contracts (Belfast) Limited was involved in the distribution of agricultural machinery, construction machinery and motor homes. The Managing Director was Mr Ernest Arnold and the Finance Director was Mr Denis Gill.

(6) In or about 2006 the claimant was approached by the owner of the company and asked was he interested in buying the company and becoming a 50% shareholder as the owners were retiring. The claimant and Mr James Wilson each bought 50% of the shareholding in the company on 22 October 2008.

(7) The claimant entered into a new contract of employment on 22 October 2006 with Saville Tractors (Belfast) Limited. He was provided with a written contract of employment which was signed on 22 October 2006. All employees were provided with a revised written contract of employment.

(8) From 22 October 2006 the claimant earned £69,500 per annum which amounted to £5,791.67 per month gross and £3,689 per month net.

(9) Under the claimant's contract of employment he was described as an employee director who reported to the Board.

(10) His contract of employment also required him to undertake such other duties from time to time as the company might reasonably require.

(11) The contract also stated at paragraph 4.3 – "The employee is entitled to take remuneration as dividend instead of salary if he so wishes".

(12) The contract of employment also set out the claimant's hours of work as being between 9.00 am and 5.30 pm and his holiday entitlement.

(13) The claimant was required to give four weeks' notice of any proposed holiday dates which had to be agreed in writing by the directors and there was a limit as to the amount of holiday leave that he could take at any given time.

(14) The contract also enabled him to carry over untaken holiday leave into the next holiday year. The contract also provided at paragraph 8.4 – "If the employee for any reason does not take all of his/her holiday entitlement in any holiday year … the employee is entitled to a payment in lieu …" The claimant claimed for 25 days of untaken holiday leave. The respondent did not challenge that the claimant had 25 days of untaken holiday leave.

(15) The contract also provided for sick absence payments to the claimant and requirements for self-certification, doctor's certification and submission to medical examination. The claimant also was entitled to full salary for six months if sick followed by half salary for a further six months and thereafter statutory sick pay.

(16) The contract also contained provisions about termination and notice periods, summary dismissal, disciplinary and grievance procedures, pensions and other obligations including post-termination obligations.

(17) The claimant explained that the provisions of the contract were those advised by his advisors Deloitte & Touche who had acted for him and his co-shareholder James Wilson when they purchased the shareholding in the company from the previous owners. He explained that the provision whereby he could have his salary paid in part by dividend did not give him any financial advantage. He believed that there were advantages to the company in that the liability for national insurance contributions was reduced by this method of payment and he accepted in the course of the hearing that there was likely to be an advantage to the company in the amount of tax payable to the HRMC by reason of this method of payment.

(18) From October 2006 onwards the claimant's salary was paid by way of dividend (£63,500) and under the PAYE scheme (£6,000).

(19) For the tax year to 5 April 2012 under the PAYE scheme the claimant received £3,517.68. The balance of the monies due to him under his annual gross salary of £69,500 was paid by way of dividend.

(20) In July 2012 the claimant's method of payment changed in that all his gross salary of £69,500 was paid under the PAYE scheme. The claimant explained that this arose because the company's bank Danske Bank insisted that he be paid under the PAYE scheme and not by way of dividend. The claimant explained that this was not challenged and that as the company had not produced a profit by July 2012 the bank would not continue to provide the overdraft facility on foot of covenants between the bank and the company.

(21) Historically the company's income was such that the first six months of the calendar year generally revealed a loss with recovery in the second six months thereby giving the company a profit over the year as a whole.

(22) From July 2012 when the claimant was paid exclusively under the PAYE scheme his salary did not change.

(23) In or about December 2012 the company faced a VAT bill of £350,000 which it was unable to satisfy. This arose by reason of a review of VAT payments made by the company. Previously the company had operated a scheme whereby motor homes were zero rated for disabled persons for the purposes of VAT. The company had been informed that this method of doing this was perfectly proper. However despite remonstrating with the VAT authorities they were unmoved and issued their demand for £350,000 in December 2012. The company was unable to satisfy that demand and ceased trading. The claimant's last day of work was 1 February 2013. It was not challenged that he did not receive any notice of the termination of his employment.

(24) On foot of losing his job on 1 February 2013 the claimant seeks a redundancy payment, notice pay, holiday pay and arrears of wages of £267.31. While the respondent did not accept the claimant's calculation of each of his claims it did not offer alternative calculations.

(25) Since 2006 when the claimant and James Wilson became 50% shareholders each in the company they effectively were in charge of the business. In relation to holiday leave each director applied to the other director and sought his approval. The claimant indicated that he had been in the past refused leave he was seeking by his co-director and he had accepted and abided by that.

(26) The company had around 22 members of staff.

(27) The claimant was responsible for sales, administrative services and part-time staff. The other shareholder was responsible for the day to day business of the company.

(28) The claimant was responsible for the signing and processing of all purchasing invoices from approximately 170 suppliers and for the payments made to them. He did bank lodgements and was responsible for locking the premises in the evening. He also was responsible for dealing with the bank in relation to its overdraft facility and in the preparation of audits as required. He made all the VAT returns and fair employment monitoring returns. He produced the full financial accounts to the auditor.

(29) Mr Wilson and the claimant were the only directors of the company.

(30) Prior to July 2012 the claimant's salary as paid under the PAYE scheme was reduced to £3,570.68 because he availed of a child voucher provision sanctioned by HMRC which allowed £243 per month to be used by employees to pay for childminding services which amount was deducted gross from his salary before it was taxed. He also availed of a scheme promoted by HMRC whereby bicycle materials and equipment could be bought up to a value of £1,000 thereby reducing the gross salary that was subject to tax by that amount. The claimant had used the child voucher scheme since 2007.

(31) The claimant applied to the respondent for redundancy payment, notice pay, holiday pay and arrears of pay by way of a RPI application on 28 February 2013. The respondent rejected the application by letter of 30 April 2013. The respondent was asked to review his decision and by letter of 31 May 2013 it informed the claimant that it continued to reject his application.

(32) The respondent rejected the claimant's application because he was not an employee as defined by Article 3 of the Employment Rights (Northern Ireland) Order 1996.

[8] The Tribunal stated that it was satisfied that, looking at the substance and not the form of the money received by the claimant, the so-called dividend was in reality an emolument for services rendered by the claimant to the company and therefore should be treated as salary.

[9] In reaching that conclusion the Tribunal referred to Clarke v Clarke Construction Initiatives Limited and Secretary of State for Business Enterprise and Regulatory Reform v Neufelt (cited above) and in addition referred to the Commissioners for HM Revenue and Customs v P A Holdings Limited [2011] EWCA Civ. 1414. It was there stated by Moses LJ at paragraph [39] that the court should not be seduced by the form in which the payments (that is the dividends declared in respect of the shares in the company) reached the employees, but rather should focus on the character of the receipt in the hands of the recipients. In that case the Tribunal had asked whether the payments were in reference to the services rendered by the employees as rewards for services past, present or future and it concluded that the payments were emoluments or earnings.

[10] A review of the original decision was undertaken in the interests of justice under Rule 34(3)(e). The appellant relied on Eyres (Surveyor of Taxes) v Finnieston Engineering Company Limited [1916] 7 TC 74 to support the contention that a shareholder who received dividends from his shareholding did not receive remuneration. However the Tribunal expressed the view, relying for support on

commentary in Harvey on Industrial Relations and Employment Law, that dividends may be emoluments or payment for services.

[11] At the review the Tribunal also rejected the Department's argument that the contract of employment was a sham. Reference was made to the decision of the Supreme Court in Autoclenz Limited v Belcher [2011] UKSC 41. The Tribunal stated two situations where it was entitled and obliged to regard a particular purported contract of employment to have been legally ineffective and concluded that neither situation applied in the present case. The two situations were stated to be -

(i) If the contractual documents have been executed with the intention of giving the appearance of creating legal rights and obligations which are different from the actual legal rights and obligations which the parties intended to create.

(ii) If the parties enter into a written contract which does not represent their true intentions and expectations.

[12] The outcome of the review was that the Tribunal concluded that the claimant received dividends as an alternative way of receiving his remuneration for services rendered or to be rendered at his election; that the payment by way of dividends was intended from the outset to be remuneration and the contract quite clearly stated so; that having considered the decision in Eyres the Tribunal was not persuaded that it should change its decision on the applicability of the decision in P A Holdings in the circumstances of the present claim.

Grounds of appeal

[13] The appellant's grounds of appeal were as follows:

(i) In determining that the respondent was an employee for the purposes of Article 3 of the Employment Rights (NI) Order 1996 the Tribunal failed to properly direct itself in law and/or properly apply relevant law and by reason of such error reached the wrong outcome.

(ii) In its decision and the reasoning contained therein the Tribunal failed to adequately explain its determination that the claimant was an employee for the purposes of Article 3 of the Employment Rights (NI) Order 1996 and therefore erred in law.

(iii) In determining that the claimant was an employee for the purposes of Article 3 of the Employment Rights (NI) Order 1996 the Tribunal acted irrationally, perversely or otherwise erroneously in law.

(iv) The Tribunal erred in law and in fact by failing to address the matter set out in Part I and Part II of the schedule to the decision of the Court of Appeal in Crawford and Dunlop v DEL [2014] NICA 26. In particular the Tribunal failed to address adequately or at all the matters set out in Part I paragraph [17] to [24] of the said schedule.

(v) The Tribunal erred in making no finding in relation to the fact that the PAYE payments made to the claimant prior to 2012 were lower than the national minimum wage and the purported contract of employment was therefore in breach of the National Minimum Wage Regulations.

(vi) The Tribunal erred in failing to apply correctly the factors approved at paragraph [98] of Neufeld [2009] EWCA Civ. 280 to the facts of the claimant's case.

[14] In its skeleton argument the appellant stated that the central issue in this appeal was whether the receipt of payment in the form of dividends was incompatible with an employment relationship. The appellant contended that payments made in the form of dividends to a person who could elect whether to receive payment by way of dividend was not compatible with that person having the status of an employee.

[15] In Eyres the Articles of Association of a company contained a provision that the dividend on shares held by directors was to be regarded as part of the remuneration of the directors. The issue was whether the dividends on the shares held by the directors were an admissible deduction in computing the profits of the company. The directors claimed that the payment of the dividends to the directors who devoted their whole time and attention to the business amounted to the earned income of the directors and formed part of the remuneration of the directors and therefore should be allowed as an expense in computing profits.

[16] What was the basis on which the directors received the payments? Article 73 of the Articles of Association provided that "The directors shall be entitled to set apart and receive for their remuneration the dividends declared on shares held by them, and also such sum or sums as the company may in general meeting determine and the monies so allowed shall be divided among the directors as they themselves shall decide. They shall be repaid all travelling expenses or other actual outlay incurred by them on behalf of the company."

[17] The Lord President concluded that the directors -

> "…. were entitled to have their shares, salary or no salary, services or no services, and accordingly the question really resolves itself into this, whether the right of the (directors) to receive their dividends was granted to them by way of remuneration for their

> services. The answer to that question is, of course, that it was not – that they could not have withheld the dividend from the (directors) which was declared on 26 March 1913 – and accordingly I come to the conclusion that these dividends ought not to be deducted from the profits, and they form part of the profits of the year and ought to be assessed accordingly."

[18] Eyres involved Articles of Association that stated that dividends on shares held by directors were to be regarded as remuneration. That was found not to be the reality. The payments were found to be an apportionment of profits and not remuneration for services rendered. The issue concerned taxation of company profits and admissible deductions from profits, which did not include dividends paid to shareholders.

[19] In P A Holdings the company wished to pay employees discretionary annual bonuses. Employees who would have been paid bonuses were awarded shares and received dividends. The issue was whether the payments received by the employees as dividend income were subject to Schedule F and also exempt from liability to national insurance contributions. Moses LJ stated that the court should not be restricted to the legal form of the source of the payment but should focus on the character of the receipt in the hands of the recipient (para [37]); that the Court should not be seduced by the form in which the payments (that is the dividends declared in respect of the shares) reached the employees but should focus on the character of the receipt in the hands of the recipients (para [39]); the Tribunal asked whether the payments were in reference to the services rendered by the employees, as rewards for services past, present or future and concluded that the payments were emoluments or earnings (para [40]); for at least 60 years courts have identified the character of a receipt in the hands of the recipient by looking at its substance and not its form (para [41]); the payments received by the employees owed nothing to fluctuations or increases in the value of shares in the company and everything to the amount which P A Holdings had decided to award as bonuses to its employees; the quantum of that which the employees received was entirely dictated by the amount P A Holdings decided to award as bonuses; the receipts were triggered by P A Holding's decision to continue its policy of making bonus payments (para [43]).

[20] It is not only in tax cases that substance should prevail over form. Nor is it only in tax cases that attention should focus on the character of the receipt in the hands of the recipients. The question is whether the payments made in the form of dividends were made for services rendered by employees on foot of a contract of employment. That is a question of fact. The Tribunal decided that question of fact in favour of the respondent. It found that the payments were made for services rendered on foot of a contract of employment. In effect the appellant's challenge is to that finding of fact.

[21] The Tribunal's conclusion was based on the Tribunal's findings that the claimant entered into a written contract of employment with the company to

provide services to the company at a salary of £69,500 per annum; that the contract provided that the claimant was entitled to take remuneration as dividend instead of salary if he so wished; that the contract contained many other clauses consistent with the status of an employee; that the claimant conducted himself according to the terms of the contract; that there was nothing in his actions that was not consistent with him having a contract of employment; that the claimant was an employee; that the payments were made as dividends and the claimant and his co-director declared the dividends; that the dividends were not related to the current profitability of the company and dividends were also declared in years when the company made a loss and such dividends were paid out of retained profits; that the dividends paid reflected the salary entitlement of the claimant under the contract of employment; that the contract of employment was not a sham.

[22] The outcome in Eyres was also fact sensitive. The decision does not establish, as a matter of principle, that the payment of dividends to a shareholder cannot be received as remuneration for an employee. Whether that is so depends on a finding as to the basis on which the payment was received, namely whether it was remuneration for services rendered under a contract of employment.

[23] The appellant points to an added ingredient in the present case. The entitlement to the dividend depended on the claimant, as recipient of the payment, in his capacity as a director of the company, declaring a dividend. Further the claimant had power to elect to receive remuneration as dividend rather than salary. The appellant contends that the power of the recipient to declare the dividend and the power to elect to receive payment by way of dividend are inconsistent with the status of an employee. Of course the claimant does not declare the dividend as an employee but as a director and would be entitled to receive a dividend based on his status as a shareholder. Ultimately, the question remains as to the basis on which the claimant received the payment. When the recipient of the payment is a director and a shareholder and the Tribunal is required to determine whether the recipient is also an employee, the issue for the Tribunal remains whether the payment was for services rendered under a contract of employment and the focus remains on the basis on which the payment was made.

[24] From October 2006 to July 2012 the claimant was paid under PAYE (£6,000 and then £3517.68) with a dividend making up a total gross payment of £69,500. From July 2012 to February 2013 the claimant was paid £69,500 gross under PAYE. The change to PAYE occurred at the insistence of the company's bank. It is apparent that throughout the period the total payment was intended to reflect the salary of £69,500 stated in the contract. The stated payment did not depend on the profitability of the company. The dividends were declared to achieve the stated payment regardless of the profitability of the company.

[25] There may be tax issues arising from receipt of remuneration as dividends rather than through PAYE. That is a matter for the revenue authorities. However the tax implications of the claimant's contractual arrangements are a different issue.

[26] The appellant objects that the PAYE element prior to 2012 was in each year lower than the national minimum wage. The statutory scheme is provided by the National Minimum Wages Act 1998 and the National Minimum Wage Regulations 1999. The appellant contends that as the PAYE element was below the national minimum wage that represents a breach of the statutory scheme which taints the contract with illegality so as to render it void and unenforceable. We cannot accept this argument. The claimant's salary was £69,500 per annum. The arrangements for payment cannot conceivably engage the national minimum wage legislation.

[27] The appellant contends that some of the questions set out in the schedule to the judgment in Crawford and Dunlop v DEL were not addressed by the Tribunal. The schedule contains guidelines for the enquiry required in such cases. The appellant makes particular reference to the factors in paragraphs 17 – 24 of the schedule having been omitted. They relate to the claimant's role as director and role as employee; other posts in other businesses; treatment of the claimant and other employees; the requirements of Directors Service Contracts; company dividends and loans. Some of these factors were addressed by the Tribunal. However it is not a precondition of Tribunal decisions that they itemise a response to every factor. This court is satisfied that the Tribunal made adequate and appropriate and sufficient enquiries to enable it to reach the conclusion in the circumstances of the present case.

[28] This Court is satisfied that the Tribunal applied the correct legal principles, applied correctly the Neufeld factors, set out the reasons for its decision, did not reach a conclusion that was irrational or perverse or erroneous in law, did not offend the statutory scheme for a minimum wage and addressed appropriately the factors in the schedule to Crawford and Dunlop. That being so this Court has not been satisfied on any of the appellant's grounds of appeal. The appeal is dismissed.