



CM ADVOCATES LLP

ARE DIRECTORS EMPLOYEES

THE INTERSECTION BETWEEN THE EMPLOYMENT ACT AND THE COMPANIES ACT

INTRODUCTION

Directors are the governing organ of a company. They are in many contexts known as the 'mind' of the company as the Board is ultimately responsible for authorizing, implementing and undertaking all actions for and on behalf of a company. The duties, roles and responsibilities of directors are usually governed by the Companies Act. This Act lists the fiduciary duties, provides for the appointment as well as the removal of directors from the office they hold.

Directors can be independent non-executive, non-executive or executive. **Executive directors** are those directors involved in the day-to-day management of the company. They usually sit at the senior management level and are largely regarded as senior employees within an organization. Some positions occupied by executive directors include Managing Director; Chief Financial Officer; Chief Executive Officer and other c-suite officers. On the other hand, **non-executive directors** do not participate in the day-to-day management of the company. Their primary role is to provide oversight and contribute to the development of strategy. The position they hold on the board is usually as a result of their connection with or position as shareholders. **Independent non-executive directors** are non-executive directors who do not have any affiliation or connection with the shareholders or management of the company. They provide independent advice and play a crucial role especially in sensitive industries such as finance and insurance. Except for specific industries, a company is not required to have a mix of

all three types of directors. The mix of all three, however, ensures representation, expertise, independence and accountability- which are all tenets of good corporate governance.

Directors are not usually considered to be employees seeing as their roles and relationship with the company usually differs from those of employees in other cadres. This article seeks to highlight the circumstances when a director would be considered an employee and how the law has interpreted this vis-à-vis a situation where a director is not be considered to be an employee.

THE DIRECTOR AS AN EMPLOYEE

As a general rule, **directors are officers of a company and not employees**. They make and execute decisions on behalf of the company and are in law considered to be ‘Authorised Representatives’ of a company. There are however instances when a company may, in addition to appointing a director, also assign the director senior management roles in the day to day running of the company. Where the board members comprise of executive directors who have signed a contract of service, the law views them as employees and their relationship with the Company is now governed by the Employment Act and labour regulations. The relationship between a Company and a non-executive director or an independent director (without a contract of service) is governed by the Companies Act.

When a director has signed a **contract of service, he is regarded as an employee**. The relationship must be tested against the definition of an employee under the Employment Act. The Employment Act defines an employee as “*a person employed for wages or a salary...*”. This Act also defines an employer as “any person, public body, firm, corporation or company who or which has entered into a contract of service to employ any individual and includes the agent, foreman, manager or factor of such person, public body, firm, corporation or company”. A director of company can therefore be considered an employee if the director is employed by the company for wages or a salary and the company has entered into a contract of service with the director.

WHY IS THE DISTINCTION IMPORTANT?

It is important to distinguish whether a director is an employee or not as the answer to that question affects rights, duties, remuneration, taxation and remission of statutory deductions. In particular, this distinction plays out in the following areas:

a) Remuneration

As discussed above, directors who are employees of a company are paid salaries or wages for their services. This means that the company will need to adhere to the provisions of the Income Tax Act which obligates employers to deduct from their employees’ salary, the prescribed taxes, that is P.A.Y.E., and remit this to the Kenya Revenue Authority within the prescribed timelines. The company will also be required to deduct from the director, statutory deductions such as the NSSF, NHIF and Affordable Housing Levy, and remit them together with the company’s contributions, the relevant statutory bodies.

The debate on this distinction was brought to the fore when the Finance Act 2023 amended the provisions of the Employment Act to introduce the Affordable Housing Levy to be paid by all employees at the rate of 1.5% of their gross monthly salary. Following this amendment, the Kenya Revenue Authority gave a directive that Affordable Housing Levy deductions were applicable to allowances paid to directors. This necessitated the CEO of Kenyatta National Hospital to write to the Attorney General for an opinion on whether directors' allowances were subject to the deduction which by statute was to be applied to employees' salaries. The Attorney General advised that directors are not employees, therefore they were not required to pay Affordable Housing Levy. Parliament has since enacted a substantive legislation on Affordable Housing, that is, Affordable Housing Act. This Act repealed the provisions of the Employment Act on Affordable Housing Levy introduced by the Finance Act 2023. Under the Affordable Housing Act, all persons are required to pay Affordable Housing Levy and the same is not restricted to employees only.

b) Employee Rights

A company must adhere to the provisions of the Employment Act on the basic minimum terms of employment which a director who is an employee is entitled to. These terms include the following:

- i) Annual leave of at least twenty-one working days in every twelve consecutive months of service;
- ii) Three months maternity leave for female employees and two weeks paternity leave for male employees;
- iii) Sick leave;
- iv) Right to be given one day rest in every seven days of service;
- v) Right not to be discriminated from employment;
- vi) Right to receive equal pay with other employees for work of equal value;
- vii) Right not to be required to work during public holidays, or to be remunerated at twice the director's hourly salary rate if the director works during rest days and public holidays;
- viii) Right to provision of clean water and medical attention in case of sickness;
- ix) The right to provision of housing at the expense of the company or an allowance necessary for the director to obtain reasonable accommodation; and
- x) One-month pre-adoptive leave for an employee whom a child is to be placed in the continuous care and control of in accordance with the provisions of the Children Act.

It is important to distinguish between the application of the law as only employees are entitled to the rights listed above. A director who is not an employee cannot approach the court on the basis of the foregoing rights.

c) Termination

A director of a company may be removed from office before the end of the term of the director in

accordance with articles of association of the company and the provisions of the Companies Act. Section 139 of the Companies Act provides that a director may be removed from office before the end of the director's period of office through an ordinary resolution of the company. However, a special notice must be served on the shareholders as well as the director and the director must be given a right to be heard at the meeting.

In contrast, termination under the Employment Act is provided for under Part VI of the Employment Act. Termination of an employee must be done in compliance with the law and when this is not done, such termination is deemed to be unlawful. Below are some instances under which an employment relationship may be terminated:

i) Termination by notice

This termination must however be for cause.

ii) Termination on account of redundancy

It is illegal for an employer to terminate the contract of an employee on account of redundancy unless the provisions of the Employment Act are followed to the letter.

iii) Summary dismissal

This happens when an employer terminates an employee's employment without notice or with a shorter notice than to which the employee is entitled to. Employers are not allowed to dismiss an employee from employment summarily unless the employee has by conduct fundamentally breached its obligations under the employee's contract of service. Such an employee must be given a fair hearing in accordance with the rules of Natural Justice and Fair Administration of Justice.

In the case of *Galgalo Jarso Jillo v Agricultural Finance Corporation [2021] eKLR* the court held that: -

"[29.] My understanding of these provisions of law is that they seek to substantially regulate termination of contracts of service particularly by an employer. First, an employer may not terminate an employee except for good cause... [30.] But even where there exists substantive ground(s) to justify a termination, the law obligates the employer to observe certain procedural strictures to ensure the upholding of the broad principles of natural justice in processing the separation between him/her and the affected employee..."

CONCLUSION

It is very crucial for a company to distinguish whether its directors are employees or not. As illustrated above, it is from the relationship that rights and duties flow. To protect the company as well as the director or employee, as the case may be, the company should have in place clear and concise terms upon which a director is engaging with the company or offering his services. It is advisable that all non-executive directors have a Letter of Appointment detailing their duties and all terms of engagement. This is not only a good corporate governance measure but serves to secure the interests of both parties. On the other hand, executive directors must have properly drawn contracts of service which clearly define the employee-employer relationship between the executive director and the company.

At CM Advocates, we have a vibrant team of corporate lawyers who can help in drafting the foregoing contracts as well as the Board Charter to provide guidance to the Board and directors. This team will also provide assistance with regard to company secretarial matters and assist the Board in undertaking any required governance audits or assessment. Additionally, our Labour and Employment Law practice group can assist in drafting clear and concise employment contracts as well as the requisite essential policies such as the Human Resource Policy, Sexual Harassment Policy, Anti-bribery Policy as well as a Policy on Conflict of Interest.

If you would like to consult on this article or any other related matter, you may contact the contributors on the emails below or the commercial team through commercial@cmadvocates.com. Do also visit our website: <https://cmadvocates.com/en> for more information about us and our services.



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