

Tips and Gratuities and the Tronc system (Lecture B1392 – 23.22 minutes)

What is a tip or gratuity?

A tip, gratuity or service charge “tip” is a payment made by the customer over and above the total of the customer’s bill.

This tip may be left at the customers discretion on the table or at the bar, handed directly to the staff member, left in a tip box for distribution later, added as a discretionary service charge or mandatory service charge to the bill by the employer.

Since 1 October 2009, service charges, tips, gratuities and cover charges cannot be used to make up national minimum wage pay.

This means that all eligible workers must receive at least national minimum wage in base pay with any tips they receive being paid on top.

From 1 April 2023 the rates are:

- National Living Wage: £10.42 (aged 23 and over)
- National Minimum Wages:
 - £10.18 for workers aged 21 to 22;
 - £7.49 for a young worker aged 18 to 20 inclusive;
 - £5.28 for workers aged 16 to 17, and over the compulsory school age but under 18;
 - £5.28 for apprentices who are either under 19 or over 19 & in the 1st year of apprenticeship.

HMRC’s guidance states that where the employer imposes a mandatory service charge to a bill and that is paid out to the employees, national insurance will be due regardless of the arrangements for sharing out the money.

Tips given directly to employee

Where the customer leaves tip on the table or gives directly to the employee, and the employer is not involved, then PAYE does not apply. Tax will be due on the tips but no national insurance. The employee receiving the tip should advise HMRC of the amount by either reporting directly to HMRC or by completing a Self Assessment tax return. Tax would be collected by adjusting the employee’s PAYE tax code.

Tips given to employee by the employer

In the situation where the employer passes the tips received to the employees then PAYE and employee’s national insurance must be deducted via the payroll. The employer will also pay employers NIC.

Tips paid using the “Tronc System”

The word “Tronc” is believed to come from the French “tronc des pauvres” meaning a wooden box left in a church to collect money for the poor. In modern usage the tronc system is a special pay arrangement under which tips, gratuities and service charges are distributed to employees in the hospitality, leisure and hotel industry.

In these industries often the tips & service charges, NOT paid directly to the employer, are pooled and distributed to the staff by a third party. The employer appoints someone – head waiter or site manager, to independently allocate and pay out the tips and service charges. This system of collecting and paying out tips is known as the tronc. Using the tronc system the employee retains more of the tip than being paid by the employer.

The person responsible for administering the tronc is known as the tronc master. They are usually an employee of the business, often the head waiter, but definitely not the employer. But they can also be an independent third party such as a professional specialising in tronc system.

The tips paid out to employees under the tronc system are treated as earnings. But it is the tronc master, not the employer, who is responsible for deducting tax under PAYE under a tronc scheme set up with HMRC. This tronc scheme is separate from the employer’s own PAYE scheme.

Under the tronc system the payment of tips by the tronc master does not attract national insurance contributions where the:

- tronc master is deciding how to allocate the tips to the employees;
- employer does not pay the tips directly or indirectly to the employees;
- employer has no say in how the tips are allocated to employees.

Under the Income Tax (Pay As You Earn) Regulations 2003 the employer must notify HMRC when a tronc is set up together with the name of the tronc master. HMRC will set up a PAYE scheme in the name of the tronc master. When a payment is made to the employees the tronc master must run the payroll deducting tax but no national insurance from each payment. The payroll information will be reported to HMRC on or before payday under RTI. The tax deducted must then be paid to HMRC by the tronc master by 22nd of the month if paying by BACS or by 19th if paying by cheque.

Employment (Allocation of Tips) Act 2023

The Employment (Allocation of Tips) Act 2023 gained Royal Assent on 2 May 2023. The Act makes it unlawful for employers to withhold tips from staff and it is expected to come into force in 2024. The Act will apply to employees, workers and agency staff.

The legislation will make it illegal for employers to withhold tips from workers. It is expected that the change will help around 2 million people working in one of the 190,000 businesses across the hospitality, leisure and services sectors, where tipping is commonplace and can make up a large part of their income. It will also ensure customers know tips are going in full to workers and not businesses.

Particularly since covid, tips are more likely to go directly to the employer as customers use their credit or debit to pay their bill. It is estimated that 80% of all UK tipping now happens by card, rather than cash going straight into the pockets of staff. Currently businesses who receive tips by card have the choice of whether to keep it or pass it on to workers.

The legislation includes:

- All tips received electronically must be allocated to employees in a fair and transparent way;
- Tips must be paid out by the end of the month following the month collected;
- Employer must pass on tips to workers without deduction other than PAYE and NIC;
- Employer must keep written record of how tips are allocated;
- Employer must have a policy setting out how tips will be allocated;
- Workers have a right to make request for information on employer's tipping record;
- Worker has the right to take employer to employment tribunal if rules broken.

To help employers with this new legislation ACAS is drawing up a code of practice for employers, however as yet it has not been released for consultation.

When the measures under the Act come into force next year, if an employer has an existing tronc system in operation for cash tips then the tronc master can continue to run the tronc provided the employer is not involved in the allocation or payment of the tips.

The change in law will affect those businesses where the employer receives the tips directly into the business bank account as customers have paid their bill using credit or debit cards. In the future 100% of tips received by this method must be paid out by the employer in full to the employees. The timescale for paying out the tips is no later than the end of the month following the month in which the payment was made by the customer.

The total amount of tips received must be allocated fairly to the workers at each place of business. The employer must prepare a written policy on dealing with tips and maintain records showing how the tips have been handled for 3 years. Employees will be able to request specific information on the employer's tip records within the last 3 years.

If an employer fails to comply with their obligations under the Act an employment tribunal can order the employer to revise any allocation of tips or make a payment directly to the employee and pay compensation for financial loss of up to £5,000 per claimant. A claim can be made up to 12 months from when employer failed to comply with the legislation.

Since the employer is passing the tips on to the employee the payment will pass through payroll with PAYE tax and national insurance deducted. Employers will also pay national insurance contributions. The tips received must be paid out in full, with no deductions other than the tax and NIC.

Points to be consider with clients before changes introduced:

- Does employer have a clear tips policy?
- Are staff and customer aware of the policy?
- Is the tronc set up and operated correctly?
- If no tronc scheme in place, should one be set up to save NIC?
- What is likely effect on cashflow for the business with tips & gratuities going to staff?
- How easy will it be to separate and record tips & gratuities paid by customers to ensure all paid on to staff?

Contributed by Alexandra Durrant