

Tips, Gratuities, Service Charges and Troncs

A guide to:

- Income Tax
- National Insurance contributions
- National minimum wage issues, and
- VAT

Help and further guidance

Help and further guidance about tax and National Insurance contributions (NICs) is available from the following sources.

The Internet

Go to our website at www.hmrc.gov.uk/payee

Your Employer CD-ROM

Your Employer CD-ROM has most of the forms and guidance you will need to run your payroll throughout the year.

The CD-ROM has:

- a P11 calculator that will work out and record your employees' tax, NICs and Student Loan deductions every pay day with a linked P32 record of deductions that works out what you need to pay us
- a range of other calculators that work out car and car fuel benefit, statutory payments and Student Loan deductions.

If you have used the P11 calculator for all your employees during the year and have nine or less employees at 5 April you can send us your Employer Annual Return online.

There is also:

- a Learning Zone to help you understand payroll topics such as statutory payments, Student Loan deductions and PAYE Online
- a Payroll Basics section for new and less experienced employers explaining what to do when employing someone for the first time.

Employer Helpbooks

Our employer helpbooks are designed to help you understand and operate PAYE, NICs and other payroll related matters.

The helpbooks are for guidance only, they are not comprehensive and have no legal force.

We also have many other leaflets and booklets that give further guidance, for example:

- CWG2 *Employer Further Guide to PAYE and NICs*
- CWG5(2010) *Class1A NICs on benefits in kind*
- 480(2010) *Expenses and Benefits - A tax guide*
- 490 *Employee travel - A tax and NICs guide for employers.*

You can view, download and order the full range of helpbooks, booklets and other forms and guidance from our website at www.hmrc.gov.uk/employers/emp-form.htm or from your Employer CD-ROM.

Or you can order copies from the Employer Orderline:

- by phone **08457 646 646**
- by fax **08702 406 406**.

Forms and guidance in Braille, larger print and audio

For details of employer forms and guidance in Braille, larger print or audio call the Employer Orderline on **08457 646 646** and ask to speak to the Customer Service Team.

Yr Iaith Gymraeg

Ffoniwch **0845 302 1489** i dderbyn fersiynau Cymraeg o ffurflenni a chanllawiau.

By phone – Employer Helplines

New employers and employers with less than three years payroll experience

New Employer Helpline
0845 60 70 143
8.00am to 8.00pm
Monday to Friday
8.00am to 5.00pm
Saturday and Sunday

Employers with more than three years payroll experience

Employer Helpline
08457 143 143
8.00am to 8.00pm
Monday to Friday
8.00am to 5.00pm
Saturday and Sunday

If you have a hearing or speech impairment, and use a **textphone**

0845 602 1380
(only people with specialised equipment such as Minicom are able to use this service)

A list of Helplines and opening hours is available:

- on our website at www.hmrc.gov.uk/contactus/helplines.htm
- on your CD-ROM, and
- in your Employer Bulletin.

Help and advice about national minimum wage can be obtained from www.businesslink.gov.uk or by calling the Pay and Work Rights Helpline on **0800 917 2368** 8.00am to 8.00pm Monday to Friday and 9.00am to 1.00pm Saturday.

Your HM Revenue & Customs office

Your own HM Revenue & Customs (HMRC) office can also help you. All our office contact details are on our website at www.hmrc.gov.uk/local/employers/index.htm

Please tell us your employer reference which is on correspondence from your HMRC office.

In person

We can help with many payroll topics, explaining:

- what you need to do
- the deadlines you need to meet
- the forms you need to fill in
- the records you need to keep.

This education is available through a range of workshops which are free of charge. Further information is available from our website at www.hmrc.gov.uk/bst or by calling the Advice Team on **0845 603 2691**.

Online Services

For information about our online services go to www.hmrc.gov.uk/online

For help and assistance using our online services, contact the Online Services Helpdesk:

- email helpdesk@ir-efile.gov.uk
- phone **08456 055 999**

open 8.00am to 8.00pm seven days a week.

Contents

	page
1 Introduction	4
2 Overview	4
3 Definitions	4
4 VAT	4
5 Income Tax	4
6 Income Tax and troncs	5
7 National Insurance contributions	5
8 National Insurance contributions and troncs	6
9 National minimum wage	7
10 Reviews of records	7
11 Legislation	8
12 National Insurance contributions: treatment of tips	9

1 Introduction

This booklet is for employers and those responsible for arrangements to share tips, gratuities and service charges amongst employees in the catering and service industries. It covers the treatment of tips, gratuities and service charges for Income Tax, National Insurance contributions (NICs), national minimum wage (NMW) and VAT purposes, including the treatment where a tronc exists.

This booklet is not exhaustive and does not cover every situation. If you are in any doubt, you can get advice from HM Revenue & Customs (HMRC) (see page 2 of this booklet).

2 Overview

A customer may make different types of payment on top of the basic charge, but usually it will be one of the following:

- mandatory service charge
- discretionary service charge
- gratuity paid to the employer as part of a cheque, credit/debit card payment
- cash gratuity paid into a staff box or similar
- cash gratuity handed directly to an employee.

This booklet explains the treatment for each of these types of payment.

3 Definitions

Tip/gratuity

A tip/gratuity is an uncalled for and spontaneous payment offered by a customer either in cash, as part of a cheque payment, or as a specific gratuity on a credit/debit card payment.

Service charge

A service charge is an amount added to the customer's bill before it is presented to the customer. If it is made clear to the customer that the charge is a purely discretionary amount and there is no obligation to pay, the payment is a voluntary service charge. Where this is not the case, the payment is a mandatory service charge. If you impose a mandatory service charge and the money is paid out to your employees, NICs are always due on the payments no matter what the arrangements are for sharing out the money.

HMRC will accept that a payment is a voluntary service charge if it is clearly presented to the customer as an entirely optional payment.

The literature seen by the customer should reflect this and be consistent with advice given to customers by employees. Any amount entered on an 'open' credit/debit card slip by a customer is likely to be a gratuity.

Tronc

A tronc is a special pay arrangement used to distribute tips, gratuities and service charges.

Troncmaster

A person, other than the employer, responsible for arrangements to share tips amongst employees.

Tips, gratuities and voluntary service charges will be referred to simply as 'tips' in the rest of this booklet.

4 VAT

Tips are outside the scope of VAT when **genuinely freely** given. This is so regardless of whether:

- the customer requires the amount to be included on the bill
- payment is made by cheque or credit/debit card
- or not the amount is passed to employees.

Restaurant service charges are part of the consideration for the underlying supply of the meals **if customers are required to pay them** and are therefore standard rated.

If customers have a genuine option as to whether to pay the service charges, it is accepted that they are not consideration (even if the amounts appear on the invoice) and therefore fall outside the scope of VAT.

Further information is available from: Notices 700 *The VAT guide* and 709/1 *Catering and takeaway food* which can be found at www.hmrc.gov.uk or by contacting the National Advice Service on **0845 010 9000**.

5 Income Tax

If customers give cash tips directly to employees or leave them on the table and individual employees keep them without any involvement from the employer, then PAYE does not apply.

It is the responsibility of the individual employee to advise HMRC of the amounts of money received. The tax will usually be recovered by an adjustment to the employee's PAYE tax code.

PAYE must be operated on all tips paid by an employer to an employee. Responsibility for operating PAYE rests with the employer even if the employer delegates the task to an employee if there is a tronc operating. You can find further advice at section 6.

There may be arrangements:

- where someone other than the employer decides how tips are shared amongst employees but does not handle the tips or have control of them, and
- where the employer makes the payment.

Where such arrangements exist the employer is responsible for operating PAYE on the tips.

Guidance on the operation of PAYE can be obtained from the employer helpbooks listed below:

- E10 *Finishing the tax year*
- E11 *Starting the tax year*
- E12 *PAYE and NICs rates and limits*
- E13 *Day-to-day payroll*, and
- CWG2 *Employer Further Guide to PAYE and NICs*.

Information on how to access this guidance is on page 2 of this booklet.

Example 1

Michael, the proprietor of a restaurant passes on all tips paid by credit/debit card to his employees.

Michael has made a payment to his employees and must operate PAYE on these payments as part of the normal payroll.

Example 2

Michelle, the proprietor of a restaurant, tells employees that all cash tips left on the tables must be handed to her so that she can ensure the kitchen staff get a share. She shares out all the cash tips amongst all employees at the end of each day.

Michelle is involved in the sharing out of the tips. She must include the amounts received as part of the payroll and operate PAYE.

6 Income Tax and tronc

A tronc is run by an individual usually known as a troncmaster. Where the troncmaster is in control of the tips and responsible for sharing them amongst employees, the employer must tell HMRC unless the arrangement came into existence before 6 April 2004. This is so HMRC can identify the person responsible for PAYE in each period.

HMRC may check an arrangement exists to share tips amongst employees and that the troncmaster accepts that role. A PAYE scheme will be set up for the tips in the troncmaster's name unless different PAYE arrangements need to be made.

The troncmaster is personally responsible for all aspects of operating a PAYE scheme. He or she may be held responsible for any failure to deduct tax from payments from the tronc. Troncmasters who need help in understanding their PAYE responsibilities should contact HMRC for advice.

A troncmaster with a PAYE scheme may use the employer's payroll to operate PAYE on his or her behalf (the employer effectively acting as a payroll agent), but the troncmaster's PAYE records must be kept separate from the employer's. The tronc PAYE scheme must be entirely independent of the employer's scheme and must be run as such.

Example 3

Frances opened a bistro in 2007. She allows the employees to keep all the cash tips and passes to them the tips received by cheque and credit/debit card in full. Mary, the head waitress, offers to collect all the tips and distribute these to the other employees each week. Frances has no involvement in this at all.

Mary is running a tronc and is the troncmaster. Frances must tell the HMRC office that deals with the PAYE for the bistro, of Mary's appointment and any future change of troncmaster.

Mary is responsible for operating PAYE in the normal way on payments from the tronc. If she fails to deduct tax from payments she makes from the tronc, she may be held personally liable.

If the employer, business partner or an official of the company (for example, a director) performs the role of troncmaster, they are considered to be making payments as if they were the employer and therefore the payments should be paid through the employer's payroll.

Example 4

Steven, a director of Hotels Ltd (the employer), is chosen by the employees to act as troncmaster.

Because he is an official of Hotels Ltd, all payments made by the tronc must be paid through the Hotels Ltd company payroll. Responsibility for operating PAYE on these payments will rest with Hotels Ltd and not Steven as troncmaster.

Where the employer is involved in deciding the distribution of tips amongst employees or if mandatory service charges are distributed through the tronc, the employer is responsible for operating PAYE. This applies even if responsibility for making distributions to staff is delegated to a trusted employee.

An employer who is unsure of their responsibilities regarding PAYE should check with HMRC **before** such payments are made.

Example 5

Lucy, the proprietor of a casino allows her gaming staff to keep any money paid in tips or left for them on gaming tables. These amounts are placed in the drop box by the gaming table. This money is kept separate from gaming money and is passed to the troncmaster for allocation amongst the gaming staff who are part of the scheme.

As Lucy is not deciding how the tips are allocated the troncmaster is responsible for operating PAYE on them.

7 National Insurance contributions (NICs)

Legislation provides that any amount paid to an employee which is a payment 'of a gratuity' or is 'in respect of a gratuity', is exempt from NICs if it meets either of the following two conditions:

- it is not paid, directly or indirectly, to the employee by the employer and does not comprise or represent monies previously paid to the employer, for example, by customers, or
- it is not allocated, directly or indirectly, to the employee by the employer.

By 'allocate' we mean deciding who should receive what amount by way of tips.

Whether either of the conditions apply will depend on the facts.

In most cases where you pass tips to an employee, you are liable for both employer and employee NICs because neither of the conditions above are satisfied.

If someone other than you is responsible for allocating the tips, see section 8 for further guidance. If:

- you are responsible for allocating tips, and
- you pass tips to your employees, and
- you consider that you are not allocating the tips either directly or indirectly

you should contact your local HMRC office for advice.

Example 6

Manjit, the proprietor of a restaurant, decides that all cheques and credit/debit card tips paid by each customer should be passed on to the employee who served that customer.

The tips received by cheque and credit/debit card are initially paid to Manjit, so they represent monies previously paid to the employer and therefore the first condition for exemption (set out in the opening paragraph) cannot be satisfied. The second condition is also not satisfied. The tips are initially paid to Manjit. He then decides who should receive what amount. Therefore, Manjit has allocated the tips to the employees. NICs are payable on these tips.

Example 7

Maria, the proprietor of a restaurant, intends that all the cash tips left on the tables will be paid to employees. To ensure the kitchen staff get a share, she collects all the cash tips and shares them out to the waiting and kitchen staff at the end of each day.

Neither of the conditions for exemption is satisfied. In relation to the first condition, Maria has paid the tips to her employees. In relation to the second condition, she decides on the allocation. NICs are payable on these tips.

Payments you are legally obliged to make to employees, such as payments which form part of a contractual arrangement or undertaking, cannot be accepted as being payment 'of a gratuity' by the employer.

A contractual payment is any payment made to an employee as part of an agreement between the employee and their employer, such as:

- any payment that forms part of the terms and conditions of the employment
- a payment that is promised, guaranteed or underwritten by the employer even if the payment (or part of it) is paid by a third party.

If, however, tips are paid to the employer, the subsequent payment from the employer to the employee, even if the payment is a contractual payment, can still be 'in respect of' a tip. If a payment by the employer is 'in respect of' a tip, NICs are due if the employer allocates the payment directly or indirectly to the employee, but NICs are not due if the employer does not allocate the payment.

Example 8

John, the proprietor of a restaurant, agrees with his employees, a minimum amount each will receive in tips. He promises to make up any shortfall if the tips do not reach the minimum amount when he distributes all the tips at the end of each week.

Where John has to make good his promise, he is meeting a contractual obligation out of his own pocket and as these payments are neither 'tips' nor 'in respect of' tips, NICs will be due on the payment.

Where John does not have to make good his promise, the payments he makes derive from the tips paid by the customers, so are payments in respect of tips.

John satisfies neither of the conditions for exemption because he decides how the tips would be allocated and pays the amounts to the employees. So, NICs are also due on these payments.

8 National Insurance contributions and trons

Where payments made from a tronc attract NICs liability, the troncmaster is not required to pay NICs on those payments. Responsibility for calculating any NICs due and making payment to HMRC rests with the employer.

Payments of tips do not attract NICs if the:

- troncmaster is allocating money that originally was not paid to the employer and the employer does not pay the money directly or indirectly to their employees, or
- employer does not determine, directly or indirectly, the allocation of those tips.

By 'allocate' we mean deciding who should receive what amount by way of tips.

Example 9

Martha, the proprietor of a restaurant, includes in the chef's terms of employment that he will get £200 wages and £400 from tips each week. At the end of each week Martha deducts £400 from tips to pay the chef. Martha passes the balance of tips to Joe, the troncmaster. Joe decides entirely independently of Martha which employees will get payments from the tronc and the amounts each will receive.

The £400 per week from tips paid by Martha to the chef, are payments in respect of tips. NICs are due on the wages and the tips paid by Martha because:

- she pays that amount direct to the chef, and
- the amount paid to employees is from money paid by customers to Martha, and
- Martha allocates that amount to the chef.

However, Martha is not involved in the allocation of the tips paid by Joe because she is not involved in determining who should receive the tips and how much each employee should receive. If Joe chooses to pay the chef any amounts from the tronc monies Martha passes to him, no NICs will be due on those amounts.

Example 10

Frank runs a casino. Tips paid by cash, cheque and credit/debit card are all passed to Sharon, the troncmaster, who has been appointed by Frank. Sharon operates PAYE on the tips that she distributes. A staff committee decides on the allocation and Frank has nothing to do with this.

Even though Frank has appointed Sharon as troncmaster he has played no part, directly or indirectly, in the allocation of the tips because he is not involved in

determining who should receive tips and how much each employee should receive. In these circumstances, no NICs will be due on the tips received by the tronc members.

Example 11

The facts are the same as in Example 10 except that rather than the staff committee allocating the tips, Frank requires Sharon to operate a points system he devised.

Frank is indirectly allocating the tips because Sharon is effectively carrying out Frank's wishes as regards allocation of the tips. All tips paid out from the tronc will be liable for NICs. Frank will be liable for operating NICs on the payments.

But if the staff committee or Sharon decide themselves to adopt and use the points system and there is no element of compulsion, then Frank has not been involved in the allocation and NICs are not due.

Example 12

The facts are the same as in Example 10 except that Frank chooses to retain some of the tips received by cheque or credit/debit card to cover card charges.

Frank is affecting the overall amount available for allocation. But he does not determine who should receive the tips and how much each employee should receive. He does not directly or indirectly allocate the tips. Sharon allocates the tips according to rules determined by the staff committee. No NICs are therefore due on the tips distributed from the tronc.

Example 13

Shelagh is the proprietor of a restaurant. In the employment contracts of all her employees she includes a right to participate in the tronc arrangements. That right leads her employees to expect they will receive a share of the tronc.

Shelagh does not get involved in allocating the payments nor does she make any further payments to supplement the tips payable.

Tips paid from the tronc in such circumstances will not be liable for NICs. Although there is a right to participate in the tronc arrangements there is no contractual right to receive payments of any specified amount out of the tronc.

Example 14

Ping, the proprietor of a restaurant, agrees with his employees a minimum amount each will receive in tips from the tronc. At the end of each week the troncmaster tells Ping whether a top-up payment is required to ensure that the employees receive the minimum amount of tips.

Ping has a legal obligation to make contractual payments to the extent he makes any top-up payment. The existence of the legal obligation prevents top-up payments from being a tip. Nor are they payments in respect of tips.

NICs are also due on the minimum payments derived from tips if Ping directly or indirectly allocates those payments.

If employees receive amounts from the tronc that exceed the minimum amount and Ping does not directly or indirectly allocate those payments, no NICs will be due on amounts paid in excess of that minimum.

Example 15

Bruno and Antonio run a restaurant. The tips are paid from a tronc run by Dino. The other employees elected him. He decides who will participate in the tronc arrangements and how much each participant will get. Dino has chosen to restrict tronc membership to those who have worked in the restaurant for a minimum of six months.

Bruno and Antonio point out to Dino there are problems with recruitment. They suggest Dino might consider extending participation in the tronc but it is clear they do not impose anything regarding the way Dino operates the tronc arrangements. Dino decides, with his employees' approval, to allow all his employees to participate in the scheme.

Bruno and Antonio have influenced who shall participate in the tronc arrangements, but they have not determined how much each person receives. They are not directly or indirectly allocating the tips because Dino continues to determine who gets what. Therefore, in these circumstances no NICs are due on the tips distributed by the tronc.

9 National minimum wage

The right to be paid the national minimum wage (NMW) is a statutory right. Regardless of any written or oral agreement between the employer and the worker, the law makes it clear that the worker has a statutory right to be paid at least the NMW by their employer.

For pay reference periods which start on or after 1 October 2009 amounts paid by the employer to the worker which represent tips, gratuities, service charges or cover charges paid by customers do not count towards national minimum wage pay.

For pay reference periods which started prior to 1 October 2009, tips, gratuities, service charges and cover charges could count towards national minimum wage pay if they were paid by the employer to the worker via the employer's payroll.

10 Reviews of records

From time to time HMRC carry out reviews of employers' records to make sure things are in order for PAYE, NICs and separately for NMW. If there is both an employer PAYE scheme and a tronc PAYE scheme then it is likely, though not automatic, that records for both schemes will be reviewed at the same time.

HMRC factsheets *'Employers and contractors – reviewing your records'*, *'Large employers and contractors – reviewing your records'* and the Business Link guidance *'National minimum wage law'* provide more details including:

- which records will be required
- how long to keep those records
- how the review will proceed.

11 Legislation

The tax legislation relating to arrangements to share tips is contained within Regulation 100 of Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003 No.2682).

For NICs the legislation relating to 'gratuities and offerings' is contained at paragraph 5, Part 10, Schedule 3 of the Social Security (Contributions) Regulations 2001 (S.I. 2001 No. 1004).

The national minimum wage legislation relating to tips, gratuities, cover and service charges that do not count for national minimum wage pay purposes is contained at Regulation 31(1)(e) of the NMW Regulations 1999 (S.I. 1999 No. 584).

You can get further information from your HMRC office or go to www.hmrc.gov.uk

12 National Insurance contributions: treatment of tips

