

# **Tips, Gratuities, Service Charges and Troncs**

A guide to

- Income Tax
- National Insurance contributions
- National Minimum Wage issues, and
- VAT

## Help

### We can help you

#### By telephone

(We may be record calls for quality and training purposes.)

- New employers (less than 3 years) **0845 7 143 143** open Monday to Friday, 08:00 – 20:00 and Saturday to Sunday, 08:00 – 17:00.
- More experienced employers **0845 7 143 143** open Monday to Friday, 08:00 – 20:00 and Saturday to Sunday, 08:00 – 17:00.
- Deaf or hard of hearing employers  
Textphone **0845 602 1380**

For a list of helplines and opening hours, see your Employer Bulletin.

#### In person

We have specially trained Business Support Teams countrywide who will help you understand

- what records to keep
- what returns to make
- when to send us information
- Online filing and electronic payments.

The Business Support Teams offer a range of free workshops on many topics relevant to employers.

For more information on the workshops and other ways that the Business Support Teams may help

- log on to our website, go to [www.hmrc.gov.uk/bst/index.htm](http://www.hmrc.gov.uk/bst/index.htm) or
- call the New Employer Helpline on **0845 60 70 143** and ask for details of your local Business Support Team.

Your own HM Revenue & Customs office can also help you. All our office contact details are on our website, go to [www.hmrc.gov.uk/local/employers/index.htm](http://www.hmrc.gov.uk/local/employers/index.htm)

Please tell us your reference, which you can find on all correspondence from your HM Revenue & Customs office.

If your enquiry is about one of your employees, please also tell us their National Insurance number.

#### By Internet

Log on to the employer's website, go to [www.hmrc.gov.uk/employers](http://www.hmrc.gov.uk/employers)

## Further Guidance

We have a range of Employer Helpbooks.

Included in your Employer pack is

- E10 *Finishing the tax year up to 5 April.*
- E11 *Starting the tax year from 6 April.*
- E13 *Day-to-day payroll.*

These Helpbooks are for guidance only. They are not comprehensive and have no legal force.

We also have a number of other booklets that give further guidance, for example:

- CWG2 *Employer's Further Guide to PAYE and NICs.*
- CWG5 *Class 1A NICs on benefits in kind.*
- 480 *Expenses and Benefits - A tax guide.*

You can view these booklets, and other forms and guidance on

- the Internet - go to [www.hmrc.gov.uk/employers](http://www.hmrc.gov.uk/employers)
- the Employer CD-ROM.

The CD-ROM contains most of the forms and guidance you will need as an employer operating payroll.

The CD-ROM also contains tutorials and calculators to help you work out

- Tax and National Insurance
- Statutory payments
- Student Loans

You can get a copy from the Employer Orderline. Check the Order Form in your Employer Pack for a full list of what is available and how to order.

#### Forms and guidance in Braille, large print or audio

We have a range of services for people with disabilities, including booklets in Braille, audio and large print.

For details, please ask at your local HM Revenue & Customs office.

#### Yr Iaith Cymraeg/Welsh language

Ffoniwch **0845 7 660 830** i dderbyn fersiynau Cymraeg o ffurflenni a chanllawiau.

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## 1 Introduction

This booklet is for employers and troncmasters (tronc is defined below) working 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 (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 in one of the following categories:

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

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 arrangements are in place for sharing out the money.

HM Revenue & Customs 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 staff. 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.

**Tips, gratuities and voluntary service charges will be referred to simply as 'tips' in the rest of the 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 whether or not the amount is passed to staff. 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](http://www.hmrc.gov.uk) or by contacting the National Advice Service on **0845 010 9000**.

## 5 Income Tax

PAYE must be operated on all amounts of tips paid by an employer to an employee.

Responsibility for operating PAYE rests with the employer even where the employer delegates the task to a member of staff. If there is a tronc operating see section 6.

There may be arrangements

- which are referred to as 'tronc', and/or
- where a 'troncmaster' determines the allocation of tips to staff **but**
- the employer pays the tips directly to staff and the 'troncmaster' does not handle the tips or have control of them.

Where such arrangements are in place the employer is responsible for operating PAYE on the tips.

If customers give cash tips directly to staff or leave them on the table and individual staff members retain them, without any involvement from the employer, then PAYE does not apply. It is the responsibility of the individual employee to advise HM Revenue & Customs of the amounts of money received. The tax will usually be recovered by an adjustment to the employee's PAYE tax code.

Guidance on the operation of PAYE can be obtained from the Employer Helpbooks listed below. Information on how to access this guidance is on page 2 of this booklet.

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

### Example 1

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

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

### Example 2

Michelle, the proprietor of a restaurant, allows all the cash tips left on the tables to be retained in full by the staff. To ensure the kitchen staff get a share, she collects all the cash tips and shares them out to the staff 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. The employer must notify the appointment of a new troncmaster to the HM Revenue & Customs office dealing with the employer's affairs unless the tronc arrangement came into existence before 6 April 2004. It would be helpful to identify where PAYE responsibility lies for a particular period, if all changes of the troncmaster are notified to HM Revenue & Customs. HM Revenue & Customs may check there is a tronc and a troncmaster who accepts the role. It will set up a PAYE scheme for the tronc in the troncmaster's name unless different PAYE arrangements need to be made.

A troncmaster with a PAYE scheme may use the employer 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 2005. She allows the staff to keep all the cash tips and passes to them the tips received by cheque and credit card in full. Mary, the head waitress offers to collect all the tips and distribute these to the other staff each week. Frances has no involvement in this at all.

Mary is running a tronc and is the troncmaster. Frances must inform the HM Revenue & Customs 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.

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 HM Revenue & Customs for advice.

If the employer, business partner or official of the company (for example, a director) performs the role of troncmaster they will be considered to be making payments as if 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 staff 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 has a continuing involvement in the distribution of tips to staff or where mandatory service charges are distributed through the tronc, the employer still has responsibility for operating PAYE, even where the responsibility for making distributions to staff is delegated to a trusted employee. It is therefore advisable for an employer who is unsure as to their responsibilities regarding PAYE to check with HM Revenue & Customs **before** such payments are made.

### Example 5

Lucy, a restaurateur, arranges for all cash tips to be collected by her headwaiter who pays them out to the staff on her behalf according to a formula she has set.

Lucy, the employer, is responsible for the distribution of the tips even though she delegates the task to a trusted employee. Lucy is responsible for the operation of PAYE.

## 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' will be 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
- it is not allocated, directly or indirectly, to the employee by the employer.

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

In most cases tips passed to an employee by the employer are liable for both employer and employee NICs because neither of the conditions above are satisfied. If a tronc is used see section 8 for further guidance. If

- a tronc is not used, 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 HM Revenue & Customs office.

### 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 above 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 staff. 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.

Any payment made by the employer where he has a legal obligation to the employee to make the payment in question, such as 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 tronc

A troncmaster is not required to pay NICs on payments made from the tronc. Where payments made from a tronc attract NICs liability, responsibility for calculating the NICs due and making payment to HM Revenue & Customs rests with the employer.

Payments of tips by the troncmaster will not attract NICs if

- they are not distributing money that was originally paid to the employer and the employer does not pay the money directly or indirectly to his employees, or
- the employer does not determine, directly or indirectly, the allocation of those tips. (By this we mean the employer must not decide who should receive what amount by way of tips either directly or through any other person.)

### 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 employee 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 the employer pays that amount direct to the chef and it represents money paid by customers to Martha and because 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 pub and restaurant. Tips paid by cheque, debit and credit 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 to allocation of the tips. All tips paid out by 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 debit/credit card, for example, in order to cover commissions and expenses.

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 by the tronc.

#### Example 13

Shelagh, the proprietor of a restaurant, includes in the employment contract of all her employees a right to participate in the tronc, which leads her employees to expect they will receive a share of the tronc as a whole. Shelagh does not get involved in allocating the payments nor does she make any further payments to supplement the tips payable.

Tips paid by the tronc in such circumstances will not be liable for NICs. Although there is a right to participate in the tronc 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 through a tronc run by Dino. The other staff elected him. He decides who will participate in the tronc 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. Dino decides, with the staff approval, to allow all staff to participate in the scheme.

Bruno and Antonio have influenced who shall participate in the tronc, 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.

Amounts paid by a customer as service charges, tips, gratuities and cover charges count towards NMW pay if they are paid by the employer to the worker via the employer's payroll and the amounts are shown on the pay slips issued by the employer.

Tips given directly to the worker by a customer do not count towards NMW pay.

Tronc money paid directly from the tronc to a worker does not count towards NMW pay. However, if the tronc money is passed to the employer, and is both paid to the worker through the employer's payroll and reflected on pay slips issued by the employer, then it will count towards NMW pay. It will also count towards NMW pay where the troncmaster operates PAYE on tronc distributions and uses the employer to pass the net payments to each worker, provided the amounts are paid to the worker through the employer's payroll and are reflected on the payslips issued by the employer.

For NICs purposes payments that count for NMW purposes can be payments in respect of gratuities and not be liable to NICs.

### Example 16

Miguel, the proprietor of a restaurant, pays his staff an hourly rate that is less than the NMW rate that they are entitled to. Tips are pooled and paid through a tronc run by Conchita, the troncmaster elected by the staff. Conchita decides who will participate in the tronc and how much each tronc member will get. Miguel is not involved in the allocation of the payments from the tronc.

Conchita is responsible for operating PAYE on distributions from the tronc. At the end of every week Conchita passes a payment from the tronc to Miguel with a schedule detailing the gross tronc distribution in respect of each tronc member and the net amount that should be paid to each tronc member by Miguel.

Miguel pays the net tronc monies to tronc members through his payroll with their wages, and shows the amount from the tronc on their payslips. Miguel checks that the amounts for payment from the tronc with the wages he pays through his payroll are at least equal to the NMW.

The source of the payments made from the tronc are tips paid by customers so the payments are in respect of gratuities. As Miguel is not involved in the allocation of the payments from the tronc there are no NICs due. If the payments from the tronc were not sufficient to bring the worker's pay up to NMW rates, then Miguel must make payments up to the NMW. These top up payments are not tips nor in respect of tips, so NICs will be due on any top up payments he makes.

The fact that a payment is taken into account for NMW purposes does not determine the question whether the payment is liable for NICs. A payment can count for NMW purposes but still be exempt from NICs.

### Example 17

Ned, a bistro owner, passes all tips received by cheque and credit card to an independently run tronc except for the equivalent of £2 per hour, which he pays to staff through his payroll and shows on their payslips to go towards meeting his NMW obligations. Monies paid from the tronc are not paid through Ned's payroll.

The tips that Ned pays directly to staff are monies paid by the employer through the employer's payroll. They are shown on the staff's payslips and will count towards Ned's statutory obligations to pay the NMW. Monies paid from the tronc do not count towards Ned's statutory obligation to pay the NMW because they are not paid through his payroll.

NICs are not due on the monies paid from the tronc because the tips are allocated by a tronc run independently of the employer.

## 10 Reviews of records

From time to time the HM Revenue & Customs carries out reviews of employers' records to make sure things are in order for PAYE, 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.

HM Revenue & Customs booklets COP3 and the Department of Trade and Industry's '*A detailed guide to the National Minimum Wage*' provide more details including

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

## 11 Legislation

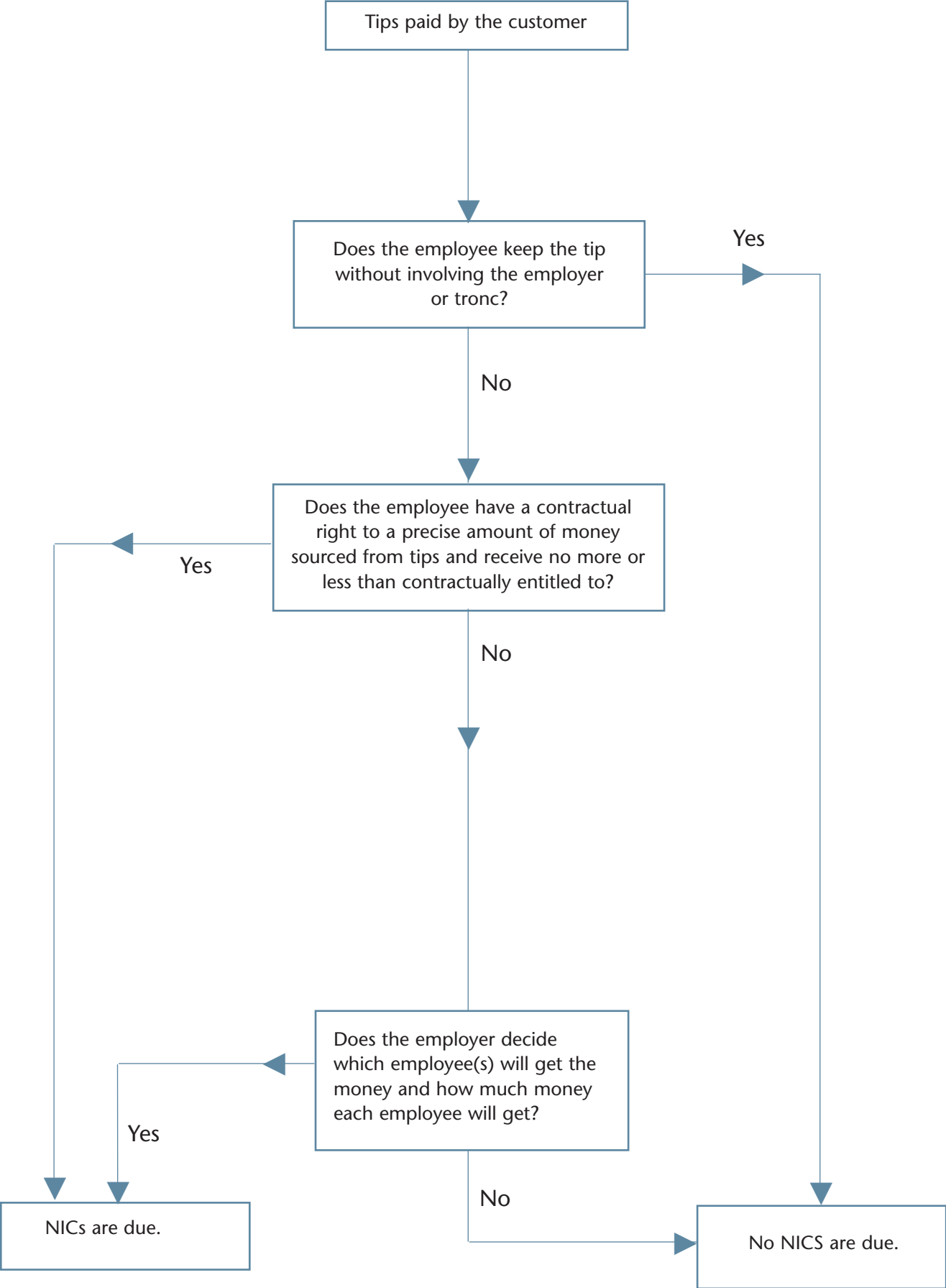
The tax legislation relating to troncs is contained within Regulation 100 of Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003 No.2682).

For National Insurance contributions 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. 1004/2001).

The National Minimum Wage legislation relating to tips, gratuities and other charges that do not count for pay purposes is contained at regulation 31(1)(e) of the NMW regulations 1999 (S.I.584 /1999).

Further information can be obtained from HM Revenue & Customs office or go to [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

**National Insurance contributions: treatment of tips**



## Treatment of tips for National Minimum Wage purposes

