



Hospitality Finance, Revenue and IT Professionals

A PRACTICAL GUIDE FOR  
THE UK HOSPITALITY INDUSTRY

TIPS, GRATUITIES,  
SERVICE CHARGES  
AND TRONCS



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*This Guide is based on the authors' understanding of relevant legislation and current HM Revenue & Customs policy and practice as at June 2018. It is for general guidance only and professional advice should always be taken in respect of your particular circumstances.*

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## → ABOUT THE AUTHORS AND EDITOR

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# 1. INTRODUCTION

We have produced this guide to support the UK hospitality industry in its efforts to make long-established practices around tips, gratuities, service charges and trons more transparent and fair. In doing so, we have also highlighted practices which are no longer ‘fit for purpose’.

UK hospitality businesses are in a unique situation among service businesses. A thriving, innovative and high-profile sector, it is constantly challenged to meet the expectations and perceptions of the public, employees, investors and authorities.

In trying to meet this challenge, practices around the distribution of tips, gratuities and service charges are regularly called into the spotlight. This guide seeks to explain your options for distributing this money in a way that complies with the law. It also outlines the tax implications of each option.

We hope this guide will inform your discussions, clarify your choices and their consequences, and help you as you strive to formulate the best approach for your particular business.

The heart of the guide includes an explanation of ‘trons’ and their operation.

## TIPS, GRATUITIES AND SERVICE CHARGES IN THE UK HOSPITALITY INDUSTRY

Service staff in restaurants, bars, hotels and event locations work as a team to provide different elements of the total experience to the customer. However, the relationship is sometimes perceived as a personal one with individual customer-facing staff members. As a result, the customer often sees tips (or gratuities) as an additional reward for the staff member they deal with most directly.

Service charges are often applied in restaurants, bars and hotels - usually as a percentage ranging from 10 to 15 percent of the menu or tariff price, or 5 percent of the accommodation price. In practice, similar percentages are sometimes added voluntarily by customers as tips or gratuities, where no service charge applies.

Service charge revenue and tips paid on with a credit or debit card can lawfully be retained by the business. The same legal status does not apply to tips paid by cash and this needs to be treated differently.

Most businesses distribute some or all of the discretionary revenues they receive from customers to their employees or use them as part of their pay structures.

These are just a few of the factors that contribute to the complexity of the subject.

## USING A TRONC

Many hospitality businesses operate a ‘tronc’ for the collection and distribution of non-cash tips and discretionary service charges. Distributing these funds through a tronc provides financial and operational benefits for all parties – business owner, employee and customer.

Trons have grown in popularity as more and more customers choose to use payment cards over cash for their transactions. This means tips and gratuities increasingly fall under the legal ownership of the business, and it is down to the business to decide how to distribute it and who receives a share. Most employers favor using a tronc to do this as the tax liability on the distribution is the same as it would be for a cash tip.

In this guide we explain the rules of operation for a tronc as well as what is required for it to be recognised for tax purposes.

## WHAT MAKES THIS SUBJECT SO SPECIAL TO THE UK HOSPITALITY INDUSTRY?

For many employees in the hospitality industry, part of their earnings are considered to be separate from their remuneration from their employer. This is the part that comes from discretionary payments made by customers for the service they receive.

Employers recognise that every staff member plays a part in delivering the service to the customer, and look to include a wider pool of team members in the distribution of the tips and gratuities under their control. Naturally this leads to a range of different approaches and policies across the industry.

Such variations can result in frustrations and misunderstandings. As a consequence, the government, unions, employers, consumer bodies and the industry are keen to develop standards that address the key issues and that are relevant to today’s business environment. This guide is designed to inform and assist in those deliberations.

Transparency is an important principle on which to base the growing body of best practice standards. The aim should be for hospitality businesses to remain free to set policies that work for them and that they communicate their practices clearly and openly to employees and customers.

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## → 2. GLOSSARY OF TERMS

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### Allocation Records

The primary records of how gratuities are allocated to members by the troncmaster. As with other accounting principles, these records must be maintained for a period of 6 years in case the tax authorities wish to inspect them.

### BEIS

The Department for Business, Energy & Industrial Strategy (formally the Department for Business, Innovation & Skills).

### Cash Tips

Cash sum left by the customer, either on the table or given specifically to the staff member and intended to be for the specific staff member.

### Contractual Promises/Guarantees

The situation whereby a tronc/troncmaster is in place, alongside contractual promises or guarantees from the business that the staff member will receive a certain amount from the tronc. Typically, such terms are set out in employment contracts or other terms of employment.

### Cover Charge

A mandatory charge applied to a bill based on the number of guests dining and typically a small fixed percentage or small monetary sum.

### Credit/Debit Card Tips

A sum added by the customer at the point of payment of the bill, generally in lieu of any service charge, although it may be an equivalent percentage of the bill.

### Deputy Troncmaster

The person responsible for the operation of a tronc if the troncmaster is absent and unable to discharge their troncmaster duties.

### Gratuity

An over-arching term for discretionary Service Charge, Credit/Debit Card Tips or Cash Tips paid by customers.

### Indirect Allocation

The situation whereby a tronc/troncmaster is in place, however the business provides the allocation structure and requires the troncmaster to follow this.

### National Living Wage

The statutory minimum hourly rate payable to workers over 25 years of age.

### National Minimum Wage

The statutory minimum hourly rate payable to workers over 16 and under 25 years of age.

### Operator

A company, partnership or sole trader that operates a business within the hospitality sector, typically a restaurant, bar, hotel or casino.

### Service Charge

An additional sum over and above the menu cost of accommodation, food or drink, or any other charge which is added to a customer's bill before it is presented to them.

Only where payment of the service charge is stated to be discretionary, optional, voluntary or suggested does it count as a gratuity.

### Tronc

An organised arrangement for the collection, pooling, allocation and distribution of gratuities.

A tronc may also be known as a tronc scheme or tronc system.

### Tronc Allocation

The process whereby the troncmaster decides how gratuities are to be divided between the tronc members.

### Tronc Committee

A body of staff members, usually representing customer facing teams, that works with and supports the troncmaster in the operation of a tronc.

### Tronc Members

Those staff that the troncmaster has decided will be within the tronc arrangements and be allocated a proportion of the gratuities.

### Troncmaster

The person (sometimes persons) responsible for the operation of a tronc. A troncmaster may be appointed by the business or by election and should not be a member of the business's senior management, a director, partner, or owner of the business.

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## → 3. DIFFERENT TYPES OF TIPS AND GRATUITIES

There are three methods by which an amount paid by a customer is categorised as a tip or gratuity:

- **A voluntary or discretionary service charge** which is an amount of money added to the bill by the operator before it is presented to the customer. In a hotel environment this may be upon checking out as a part of their overall bill, and for events bookings it may be included within an invoice
- **An additional amount added to the value of the bill or invoice when paying via a debit or credit card transaction** (or signing the bill to be charged to a room or credit account), usually upon prompting by a Chip & Pin device. Alternatively, a customer may instruct a member to staff to add a specific amount to the value of the bill or to round the bill up to a higher overall amount
- **In cash** be it by leaving money on the table, using a tip jar or similar, handing cash directly to a member of staff and specifically confirming it to be a gratuity, or by paying a bill in cash and advising that any change may be retained.

There are four ways a business can deal with tips and gratuities paid by customers. They can:

- Distribute some or all of these to staff via a tronc system (see section 7). Doing this will give taxation benefits to both businesses and employees, but will mean that the business cannot control how the monies are allocated or shared
- Distribute some or all the gratuities to staff outside of a tronc system. Doing so allows a business to control exactly how the awards are allocated and calculated, but means that the favourable taxation treatment is forfeited
- Retain some or all of the money as business revenue and use this to support other costs (including payroll costs over and above the National Minimum Wage / National Living Wage – see section 9)
- For cash tips only, allow staff to either retain their own tips or operate an informal arrangement (see section 10c).



## 4. WHAT IS A SERVICE CHARGE? ←

A service charge is an additional sum over and above the tariff or menu charge which is added to a customer's bill before it is presented to them by an operator. In a hotel environment there may also be a service charge added to a room rate charged to customers.

Typically, a service charge is calculated as a set percentage of the bill and is usually based on the VAT-inclusive total. For example:

Food and drink	£100.00
Discretionary service charge @ 12.5%	£12.50
<b>Total</b>	<b>£112.50</b>
Net sale	£83.33
VAT at 20%	£16.67
<b>Total</b>	<b>£100.00</b>

A service charge will generally represent a part of an operator's overall staffing costs but is itemised or charged separately due to the subsequent taxation treatment of any proceeds. There can be a significant financial benefit for businesses, employees and consumers if a business operates a 'pricing plus service charge' structure as opposed to an inclusive pricing model. (see Appendix 1).

Under the Consumer Rights Act 2015 a customer may only be required to pay a service charge if they were made aware of its imposition before they order. The service provided to the customer must be of a reasonable level.

For the purposes of taxation, HM Revenue & Customs view is that a customer must be explicitly made aware by an operator that payment of a service charge is at their discretion. This is typically achieved via a statement on a menu, on a website, or within terms and conditions provided to a customer at the point at which they enter into a contract with the operator; generally, this is when an order is placed for food and drink or rooms. A menu statement might typically look like this:

*'A 12.5% discretionary service charge will be added to your bill'*

As well as 'discretionary' the words 'optional', 'voluntary' or 'suggested' are often used.

Where a customer is invited to pay a service charge (and does so) this is generally treated as being in lieu of a tip and typically no additional gratuitous payment is expected.

A cover charge is not the same as a service charge. It is a non-discretionary additional amount added to a customer bill, typically in respect of a specific item (such as bread or linen) or entertainment provided. As a cover charge is a non-discretionary payment it forms a part of the general takings of a business and is not considered further within this guidance.



## → 5. LEGAL OWNERSHIP OF GRATUITIES

The legal ownership and title of amounts paid by customers forms the basis of the choices available to businesses over how these monies are subsequently dealt with, and who receives and benefits from them.

### DISCRETIONARY SERVICE CHARGES

A discretionary service charge is a charge which a customer is invited to pay by a business. Therefore, should a customer choose to make payment of that charge, the proceeds are the property of the business, and not employees (whether individually or collectively). Staff have no legal title or claim to proceeds of a discretionary service charge.

The legal ownership of service charges has been considered by the UK Courts who decided that, because this is a charge made by the business, the monies received from a customer by way of payment of that charge become the legal property of the business. The UK Court's decisions were upheld by the European Court of Human Rights in 2002 (*Nerva & Others v United Kingdom*).

The method by which a customer pays a service charge makes no difference, and the funds will be the property of the business whether paid by cash, as a part of a card transaction, cheque or other means.

### TIPS PAID BY CARD

A customer may choose to add an additional amount to a debit, credit or charge card payment made to a business. This may be in response to a prompt from a Chip & Pin machine, by writing an additional sum on a bill, or by asking a member of staff to include an extra amount or round the bill up to a higher figure.

Any such sums paid to the business via a card transaction become the legal property of the business in a similar manner to service charges.

### TIPS PAID IN CASH

A cash tip is an additional gratuitous sum paid in cash by a customer. It does not include any service charge paid in cash, nor any tip originally paid by card even if converted subsequently into cash (for example, from the employer's cash takings). The money may be handed directly to an employee, left on the table to be picked up, placed into a communal dish or jar (for example on a bar or counter) or constitute change after paying the bill, which a customer tells an employee to retain.

### TIPS PAID IN CASH DO NOT BECOME THE PROPERTY OF THE BUSINESS

An employee cannot be compelled to hand over, pool, or share their cash tips unless this has been agreed as a part of the Terms & Conditions of Employment or the employee has been expressly prohibited from accepting gratuities from customers of the business.



## 6. TRONC SCHEMES ←

### A. WHAT IS A TRONC SCHEME?

A 'tronc' (originating from the French *tronc des pauvres*, meaning 'poor box') **tronc scheme or tronc system** is a name given to an organised arrangement existing within a hospitality business to pool and share proceeds of gratuities paid by customers. A tronc is managed and controlled by an individual known as a 'troncmaster'.

It is not obligatory for a business to operate a tronc system, but a majority of hospitality operators do. There are several advantages to operating a tronc system, principally:

- Operated correctly it can deliver significant financial savings for both a business and its employees due to favourable taxation treatment; and
- It is seen as a more transparent way to deal with gratuities and can accommodate input from staff members as to how the amounts are shared and distributed.

Where a tronc exists it is typically used to distribute card tips and discretionary service charges. Cash tips are sometimes included (or may have their own separate arrangement) but this requires the agreement of staff as those tips belong to employees rather than to the business. In larger establishments (such as hotels) there may be more than one tronc operating, for example separate troncs may exist for restaurant staff and rooms staff.

In order for an arrangement to be accepted as a tronc by HM Revenue & Customs there are guidelines which must be followed. These are set out below.

### B. WHAT CAN GO INTO A TRONC SYSTEM

A tronc system may only distribute the proceeds of gratuitous payments made by customers either to a business or directly to staff. Money deriving from any other source (such as income from sales) cannot be used within a tronc system. Therefore, the maximum amount of money that a business may use to fund a tronc system is 100% of the gratuities paid by customers.

It is up to the business what proportion of the card gratuities and discretionary service charges paid by customers is made available to the tronc system. This proportion may be increased or decreased at any time if considered necessary by the business.

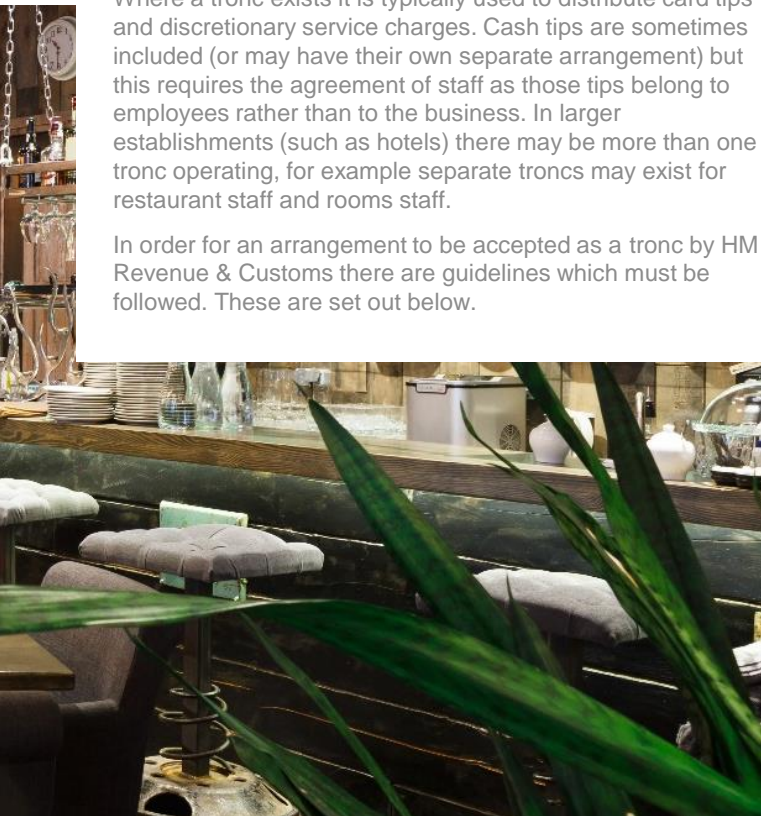
Whilst not a legal requirement, it is considered good practice (in the interests of transparency) for a business to advise employees and customers of the proportion of gratuities it retains, as these are not made available to the tronc system.

Businesses will often retain a small proportion of the card gratuities and discretionary service charges to cover direct costs associated with collecting, administering, processing and paying these monies. These may include:

- Credit card commissions and fees
- Bank charges (such as charges in respect of depositing service charges paid in cash and charges for making electronic payments)
- Payroll costs if outsourced
- Fees payable to a troncmaster if outsourced.

There is no obligation on a business to provide information to either its employees or customers regarding what proportion of the tips or service charges paid are retained by the business (either for genuine administration costs or for any other reason) and what proportion is distributed to employees. The Government however believes that this information should be proactively provided by businesses.

The tax treatment of funds within the tronc system (including whether or not the exemption from National Insurance Contributions is satisfied) is unaffected by any decision of a business to retain an element of the gratuities. The criteria relating to that exemption apply only to the proportion of funds within the tronc not the overall amount received from customers.



C. THE TRONCMaster AND THE ROLE

How is a troncmaster chosen?

It is up to the business to decide who carries out the role of troncmaster. Some businesses may allow staff to choose their own troncmaster but this is not a legal requirement.

Where staff are permitted to select their own troncmaster there is no set process that must be followed such as elections or ballots.

A business will always retain the right to relieve the troncmaster of their responsibilities should they choose to do so.

No specific appointment process must be followed but it should be clear that the proposed troncmaster is willing to undertake the role together with understanding and accepting their responsibilities.

Members of staff should always be made aware of the identity of the troncmaster. This may be communicated by the business or the troncmaster themselves.

Who can act as a troncmaster?

If a business wishes to satisfy the exemption from National Insurance Contributions, then the troncmaster should **not** be any of the following:

- The proprietor, a partner in the business, an Officer (Director or Company Secretary) of a company operating a business or any other person with a level of authority similar to this
- Any person with a significant shareholding in the business
- Any person involved in the strategic decision-making of the business (as opposed to day-to-day operational matters)
- Any person signing employment contracts or job offer letters on behalf of a business
- Any person with the authority to set or amend rates of contractual pay.

Subject to this, a business may appoint either an internal or external party to act as troncmaster. There are advantages and disadvantages to either:

	ADVANTAGES	DISADVANTAGE
INTERNAL TRONCMaster	<ul style="list-style-type: none"><li>• The troncmaster is on hand to answer any queries or questions from staff.</li></ul>	<ul style="list-style-type: none"><li>• An internal troncmaster (typically an employee) may well be a part of the operational team and based on the premises day-to-day. They will know members of staff personally and may be in a position to see those team members at work</li><li>• There is a risk that an internal troncmaster could act subject to bias, favouritism, personal friendships or similar</li><li>• If the troncmaster also wishes to participate in the arrangements themselves there may be a conflict of interest issue.</li></ul>
EXTERNAL TRONCMaster	<ul style="list-style-type: none"><li>• An external troncmaster (typically a professional specialising in tronc systems) is likely to have a greater understanding of the relevant legislation, regulations, and record keeping needs</li><li>• An external troncmaster should act impartially and independently as they will not have personal relationships with staff.</li></ul>	<ul style="list-style-type: none"><li>• An external troncmaster will make a charge for their services.</li></ul>

## WHAT ARE THE TRONCMaster'S RESPONSIBILITIES?

The troncmaster is responsible for the management and control of the tronc system. Depending on the specific circumstances they may or may not have responsibilities for payroll and making deductions of tax – see Section 9B.

The troncmaster must have, and be seen to have, authority and control over the decision-making process both as to the general methodology used and the specific amounts awarded to individual members. The troncmaster will need to maintain sufficient documents and records to demonstrate this.

The troncmaster may delegate aspects of the administration of their scheme (including to other employees of the business) but it should be clear that they act only in line with the troncmaster's instructions).

The troncmaster is responsible for ensuring that the scheme is run in a way that is fair to all members without favouritism or discrimination, and for ensuring that scheme members are provided with details and information as to how the system works and how their share is calculated.

A troncmaster may choose to have a deputy, an assistant, informal staff representatives or a formal committee to help them run and administer their scheme. This is entirely the troncmaster's decision and is not required in order to satisfy the exemption from National Insurance.

It is common practice for troncmasters to have a reserve of undistributed tronc funds which will typically be held by the business on the troncmaster's behalf. This may be used to ensure that tronc distributions can still be made during periods of quieter trading, planned closures or short term business interruptions. The troncmaster may also use their reserves to smooth out the level of the tronc awards made over the course of a year to take account of seasonal fluctuations in trade.

## WHO CAN PARTICIPATE IN THE TRONC SYSTEM?

It is entirely up to the troncmaster to decide who can participate in the tronc.

It is now commonplace for all operational staff to participate to a greater or lesser degree, including both front of house and kitchen staff. In a hotel environment, where a tronc system is funded by gratuities received from residents (for example, a discretionary service charge on room rates) then rooms staff, porters and other similar groups of employees are likely to be included.

There is no bar to a troncmaster participating in their own tronc scheme, but they should take care that no suggestion of abuse of position or making excessive or inappropriate awards to themselves could be made.

There is also nothing to prohibit senior managers and even Directors who work within the operational side of a business being included in the tronc scheme as participants. Care should be taken to ensure that any amounts awarded to them are not disproportionate and that no suggestion could be made that the troncmaster was in reality acting under the control or instruction.

A troncmaster should only include staff who are employed by the business and on the business payroll within the tronc. This can include casual or seasonal staff, but will not include staff supplied and employed by agencies. A business may choose, should they wish, to pay an element of service charge proceeds directly to an agency for onward payment to their staff (which would be via the agency payroll and subject to both income tax and National Insurance) but this is not a matter for the troncmaster.



## → 7. TREATMENT FOR VAT PURPOSES

Tips paid genuinely and freely by customers in hospitality businesses are considered to be outside the scope of VAT. The mode of payment does not change the VAT treatment of tips – cash, cheque or credit/debit card tips are all considered to be outside the scope.

Additionally, even if the customer requires a tip to be included on the bill, or some of the tip is not passed to the employees, the full amount is still outside the scope.

Service charges are treated differently from tips. Mandatory service charges are considered as part of the consideration of the contract between the restaurant and the customer. The contract is concluded when the customer pays the bill, so if [a or the] customer does not have a genuine option as to whether to pay the service charge, VAT would be charged at 20%.

On the other hand, if the service charge is discretionary, the VAT liability would be considered outside of scope. The reason for this is that discretionary service charges do not fall as part of the consideration from the customer to the business, as the customer has the option to pay it. It is important that it is clear to the customers in the documentation provided (e.g. menu, receipt etc.) that the amount is discretionary.

Where a tronc arrangement exists and it's operation results in all the proceeds of gratuitous payments and discretionary service charges made by customers being passed directly to staff, then the VAT liability would be outside of scope.

VAT could apply in any circumstance where the business makes a specific charge to the tronc for support services and mitigation of costs.

### SUMMARY OF VAT CONSIDERATIONS

- Tips and discretionary service charges are outside the scope of VAT when they are genuinely and freely given by a customer.
- The VAT treatment of a mandatory service charge is standard rated for VAT purposes.
- VAT could apply if the business makes a charge to tronc.



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## 8. TREATMENT FOR NATIONAL MINIMUM / LIVING WAGE PURPOSES

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All employees are entitled to receive a rate of pay from their employer at least equivalent to that laid out in the National Minimum Wage Regulations. These rates vary by age and the main rate (payable to employees aged 25 and over) is known as the National Living Wage. This is a statutory right regardless of whether the employee is paid on a time basis (e.g. by the hour) or salaried.

Any monies deriving from tips, discretionary service charges, and other gratuities cannot be used by a business as a part of their National Minimum Wage obligations. It makes no difference if those gratuities are processed via a tronc system or directly by an employer, or whether or not National Insurance is paid on those gratuities.

Businesses should take care that they can demonstrate that payments made to employees of amounts up to and including the relevant National Minimum Wage rates are not being funded from any of the sources of gratuities received from customers.



## → 9. TREATMENT FOR INCOME TAX PURPOSES

Tips, no matter how received, are taxable income and always subject to Income Tax. Whether or not tax has to be deducted at source (and by whom) or whether the recipient of the tip is responsible for declaring it to HMRC will depend on the facts. Businesses and employers must ensure that they fully comply with any obligations upon them, or they will be held liable by HMRC for any underpaid tax on tips.

Proceeds of discretionary service charges and tips originally paid by customers as part of a card transaction are the legal property of the business. This means that there are no circumstances in which they can be received by an employee without tax being deducted at source.

A business must not, for example, convert these gratuities into cash using business takings and distribute them without tax being deducted. If HMRC establish that employees have been paid proceeds of service charges or card tips gross (without deduction of tax as appropriate through a payroll system) by a business, then it will seek to recover the under-deducted tax from the business.

### A. WITHOUT A TRONC SYSTEM

Where no tronc system is in place the employer will always be responsible for processing the payment of gratuities through their own payroll system alongside any payment of wages and taxing the total amount using the tax code held or issued by HMRC.



### B. WITH A TRONC SYSTEM

If a tronc system is in place, either the employer or the troncmaster may be responsible for deducting tax at source. This will depend on who holds the physical tronc funds and makes the payment to the employee.

#### Employer held funds

The employer may retain possession of the actual funds themselves within their own business bank account or cash takings, and simply give the troncmaster the right to decide how those funds are allocated. They will then pay employees the relevant amount as instructed by the troncmaster, but the actual payment will be made by the employer directly to the employee. In this situation it will be the employer who is responsible for taxing the payment and this should be done through the business payroll.

No separate payroll or registration of the tronc system with HMRC is required when the business retains the physical funds and pays staff directly. The tronc award is shown as a separate pay element on the employee's payslip but the employer will make only one payment of net pay, make one RTI return to HMRC, and send one monthly or quarterly payment to HMRC as required. There is no requirement to split or separately identify the tronc payment.

This is the manner in which most businesses operate and is unrelated to whether or not National Insurance Contributions are due on the payment of gratuities (see Section 10).

#### Troncmaster held funds

Alternatively, a business may pass the physical funds to the troncmaster to hold and pay to their members. This may be in cash or by transferring the funds into a bank account controlled by the troncmaster.

Where a business passes the funds to the troncmaster, they must contact HMRC to advise them of the existence of the arrangement and the details of the troncmaster. The troncmaster will be responsible for running a separate payroll and will be registered with HMRC in their own right. They will also be responsible for paying staff, maintaining records, making Real Time Information returns to HMRC as well as paying over tax deducted. The troncmaster will have personal responsibility and liability to HMRC in respect of all obligations and monies due.

As and when a new troncmaster is appointed the business must advise HMRC of the change of troncmaster.



## C. CASH TIPS

Cash tips left by customers are taxable income if received by members of staff. Whether tax must be deducted at source, and by whom, will depend on the specific facts in a particular business.

### Cash retained directly by recipient

If an employee is given cash directly by a customer and keeps that money, then no deductions of tax at source are due. The employee will have an obligation to keep a record of those cash tips and declare them annually to HMRC. This does not require a full tax return to be completed, unless HMRC have specifically asked the employee to do so. The tax due on cash tips is typically collected via an adjustment to the employee's tax code.

### Informal pooling arrangements

If an informal pooling arrangement exists, then employees will remain responsible for maintaining a record of cash received and declaring this annually to HMRC. To be accepted as informal by HMRC the arrangements should:

- Distribute monies at the end of a shift or a day and not accumulate funds over a longer period of time
- Not amalgamate cash tips with any tips paid by card or any service charge proceeds
- Not be dealt with by anyone who acts as a formal troncmaster
- Not be managed, policed or controlled by the business.

### Formal pooling arrangements

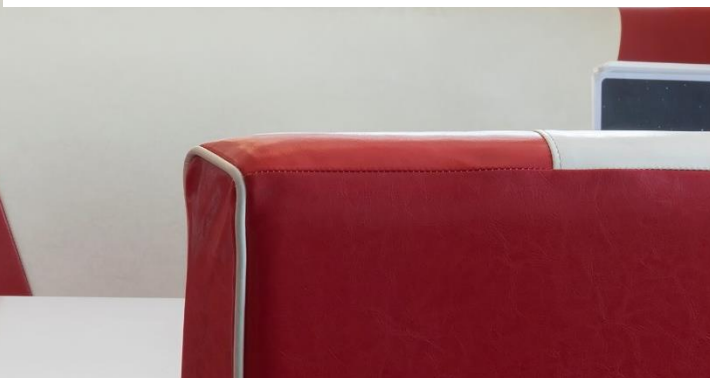
Pooling arrangements that do not meet the criteria of 'informal' must have tax deducted at source before distribution to employees. Where an employer does not take control or possession of the cash tips, but instead these are dealt with by staff themselves, then a tronc exists and an employer has an obligation to notify HMRC of the existence of the arrangement and the identity of the troncmaster. The troncmaster will then be personally responsible for running their own payroll, making deductions of tax, and making both payments and returns to HMRC.

It is possible (particularly in larger businesses) for more than one tronc arrangement to exist simultaneously.

If, alternatively, cash tips are mixed with the proceeds of card tips and service charges then they must be taxed in the same manner as the other funds, either by the business or the troncmaster.

Where a business collects cash tips and pays these directly to staff, the business will be responsible for deducting tax via its own payroll.

Where a business has an obligation to notify HMRC of the existence of a tronc and fails to do so then it will be held responsible for any tax not paid on those tips. If no formal records of the amounts exist then HMRC may estimate the amount of tips and tax thereon, and may also seek interest and penalties from a business. Disclaimers signed by staff accepting responsibility for declaring tips to HMRC have no legal force where a formal arrangement exists. They should not be used as they offer a business no protection or defence against a demand by HMRC for tax.



## → 10. TREATMENT FOR CLASS 1 NATIONAL INSURANCE PURPOSES

Unlike Income Tax, National Insurance Contributions are not always payable either by an employee or a business on the proceeds of tips and service charges received by staff. An exemption has existed in legislation for many years which, subject to one of two conditions being met, treats the payment as if it was a cash tip passing directly between customer and employee for National Insurance purposes.

The first condition is that the money received by the employee is not a payment from their employer and has not passed through the employer's hands. The second condition is that (even though it may have been paid by the employer or comprise the employer's money) it has not been allocated, directly or indirectly, to the employee by the employer.

Only monies which derive from gratuities can meet either of the two conditions. Monies deriving from any other source can never satisfy the exemption and will be within the scope of National Insurance Contributions when paid to employees.

### THE FIRST CONDITION – CASH TIPS WITHOUT A TRONC SYSTEM

Where staff retain cash tips given to them directly (section 9(C)(a)), or receive a share of cash tips from an informal pooling arrangement (section 9(C)(b)) then these amounts will not have been received from the employer or have passed through the employer's hands. The first condition for exemption will apply and the amounts will be outside the scope of both employer and employee National Insurance Contributions.

This is the only type of arrangement that can satisfy the first condition for exemption. All other arrangements will involve either money which has passed through the employer's hands (card tips and service charges) or which was paid to the employee by the business. These arrangements must instead satisfy the second condition to be outside the scope of National Insurance.

### THE SECOND CONDITION – DIRECT AND INDIRECT ALLOCATION OF GRATUITIES OTHER THAN CASH TIPS

National Insurance will be due on any payment of gratuities received by an employee where it has been allocated to them, directly or indirectly, by the business. HM Revenue & Customs define 'direct' allocation as being:

'deciding who is to be the recipient of the payment and how much the recipient is to get'.

'Indirect' allocation is defined as meaning where:

'the employer establishes and controls a system that performs the allocation in such a way that the allocation can reasonably be said to reflect and give effect to the employer's wishes'.

#### Direct allocation

So, direct allocation will be considered by HMRC to have taken place in the following situations:

- The amount received by the employee forms part of a contractual agreement between an employee and their employer
- There is no troncmaster and a decision about how much an employee is to receive has been taken by the employer or an employee acting as their employer's representative
- The employer has:
  - dictated to the troncmaster how much the employee is to receive and the troncmaster has no realistic ability to refuse this instruction
  - predetermined the amount to be received by the employee
  - overruled and changed the troncmaster's decision as to how much a particular member is to receive.

## INDIRECT ALLOCATION

Indirect allocation may cover a situation where an employer:

- Imposes a system of calculation on a troncmaster which effectively predetermines the outcome; for example, dictating a number of points that an employee is to receive
- Decides on the overall level of earnings that an employee is to receive, effectively limiting the troncmaster's freedom to decide on an award
- Compels the troncmaster to operate their tronc system in a certain way or to make changes that the employer wishes to see.

Where arrangements other than those set out above are in place they will generally be considered to meet the second condition for exemption.

It is perfectly acceptable for there to be interaction and discussion between an employer and troncmaster, provided that it is clear that nothing is imposed upon the troncmaster. Good practice is that such discussions would be documented to support the fact that no imposition by the employer has taken place.

Where National Insurance Contributions are due it is always the responsibility of the employer to deal with this, never the troncmaster.

This is regardless of whether Income Tax is deducted via the main business payroll or a separate payroll in the name of the troncmaster (see section 9B).



## → 11. CONTRACTUAL AGREEMENTS WITH STAFF

Any payment which forms part of the contractual relationship between an employer and employee will always be within the scope of National Insurance Contributions, regardless of how it is described or whether or not it is paid from tronc. It will also form the basis of any statutory payments which the employer is required to make (such as holiday pay, maternity pay and redundancy pay).

A contractual agreement takes many forms including written contracts, verbal agreements, binding offers and implied agreements arising from custom and practice. All are equally valid, although agreements which are not in writing can be more difficult to prove in cases of dispute.

Where a business promises, commits to or guarantees an overall level of earnings (for example, £12 per hour or £30,000 per annum) this will form the amount within the scope of National Insurance Contributions, even if this sum contains an element (specified or unspecified) which is to be paid via a tronc system.

It is therefore very important, both during the recruitment process and subsequent to starting employment, that an employer does not promise or commit to any amounts which the troncmaster intends to award. Any offer letters or contracts must only incorporate basic pay.

An employer may give an employee a right to participate in the tronc arrangements in place and this will not automatically bring any tronc award within the scope of National Insurance. If the employer goes further and commits to either a specific level of tronc award or an overall figure which includes tronc then this will mean National Insurance is due.

A troncmaster may give an employee details of a specific amount which they intend and have decided to award to them, and this may be communicated in writing by the troncmaster. It must always be separate from any contractual terms set out by the employer. It is also good practice to clearly set out that, although the tronc awards may be paid to the employee by the employer, the tronc is under the sole control of the troncmaster and does not form part of the employee's Terms & Conditions. The employer is merely carrying out the troncmaster's instructions in making payments to employees and because they are required by law to ensure that monies are subject to deductions of tax.

Although not a legal requirement, it is good practice for the troncmaster to provide a copy of the tronc rules and to ask the employee to indicate in writing that they have understood and accept the rules of the tronc system. This can be of assistance if an employee subsequently tries to bring a claim against their employer over tronc monies.



# APPENDIX ←

## INCLUSIVE PRICING vs SERVICE CHARGE AND TRONC

SERVICE CHARGE TRONC MODEL	INCLUSIVE PRICING MODEL		
	EMPLOYEE PAYS	EMPLOYER PAYS	CONSUMER PAYS
Revenue received from customers	£100.00	£100.00	£170.20
VAT included in receipt	£0.00	£16.67	£28.37
Receipt net of VAT	£100.00	£83.33	£141.83
Employer NI (13.8%), pension (2%) and Apprentice Levy costs (0.5%) included	£0.00	£11.68	£19.88
Gross pay	£100.00	£71.65	£121.95
Employee pension contribution (3%)	£0.00	£2.15	£3.66
Tax due at basic rate (20% - tax relief at source on pension)	£20.00	£13.90	£23.66
Employee NI contribution (12% including on pension contribution)	£0.00	£8.60	£14.63
<b>Net pay received by employee</b>	<b>£80.00</b>	<b>£47.00</b>	<b>£80.00</b>
Total taxation, levy and pension costs	£20.00	£53.00	£90.20
Additional cost to business		£0.00	£41.83
Additional cost to consumer		£0.00	£70.20
<b>Additional cost to employee</b>		<b>£33.00</b>	<b>£0.00</b>

Note. The inclusive pricing examples do not include costs for holiday, sickness and other related employer costs that would also apply





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