

FOCUS ON

# Tips & Gratuities in the Leisure & Hospitality sector

**Income from tips often forms a large part of the income of restaurant and bar staff, however it is the employer who runs the risk of settling unpaid liabilities and penalties if tax (and national insurance contributions) are not properly accounted for.**

**Below is a summary of the main points that employers in the sector need to be aware of.**

## **Income Tax**

All tips received in whatever form are taxable income subject to income tax. Tips are only tax-free if no one tells HMRC about them but that's tax evasion and illegal.

## **PAYE on tips**

Whether or not an employer is required to operate PAYE in respect of tips depends largely on the method by which they are distributed as follows:

### **Payment direct to employee**

If a customer pays a tip to an employee directly, or leaves it on the table, and the employee collects it, with no involvement of the employer, there will be no need to operate PAYE on the tip itself. However, it is the employee's responsibility to advise HMRC of the tips received each year and HMRC will adjust the employee's tax code to collect the tax that is payable.

### **Tips distributed by employer**

If tips are distributed by the employer, the employer will be responsible for the operation of PAYE on the value of the tips.

## **Troncs**

Tips are often pooled and distributed by a designated member of staff in a scheme known as a Tronc. The designated member of staff is known as a troncmaster, who will have sole responsibility for the allocation of tips amongst the staff. Where a Tronc is in place, the troncmaster is responsible for deducting tax (but not NIC) and for paying it over to HMRC. Any reporting of NI will be the responsibility of the employer (see "National Insurance" on the back page).

Where a tronc is in place, the employer is responsible for advising HMRC of its existence. Failure to do so could result in the employer facing a liability to any tax, NI, interest and penalties that may be due. Employers are also responsible for notifying the appointment or replacement of a troncmaster to HMRC.

## **Informal arrangements**

Sometimes employees arrange the distribution of tips amongst themselves, for example where employees decide to pool tips to ensure kitchen staff receive a share. If there is no formal arrangement and there is no employer involvement in the distribution of the tips, there will be no need to operate PAYE. However, the employees concerned will be required to declare the receipt of such tips to HMRC, who will alter their tax codes to collect the tax that is payable.



## National Insurance

National Insurance (NI) will only be payable in respect of tips where an employer is involved in their collection or distribution. In particular, no NI will be payable if:

- Tips are given direct to an employee or left on a table by the customer and are collected by the employee;
- Tips are distributed by a troncmaster with no involvement from the employer.

Note: where tips are handled by a troncmaster and the employer is involved allocating the tips amongst staff, the troncmaster will be responsible for the tax that is due whilst the employer will be responsible for NI.

## National Living Wage (NLW)/National Minimum Wage (NMW)

Employees have a statutory right to the NLW/NMW irrespective of any agreement made between the employee and the employer. Employers are not permitted to take account of tips, service charges and cover charges paid by customers when calculating either NLW or NMW.

## VAT on tips and service charges

Tips are not subject to VAT. Certain service charges are also outside the scope of VAT. The position depends on whether the customer has a genuine option over whether to pay the charge. This applies even where the service charge appears on the bill. The important factor is the wording on the menu, which creates the contract between the customer and the restaurant. If it is clear that a service charge will be added, VAT is due.

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However, where the service charge is described as optional, no VAT is due as the customer has a genuine option as to whether or not to pay the service charge. This is the case even if it is added to the bill without asking the customer.

The distribution of service charges to staff has no effect on the VAT position. Where VAT is due, it should be deducted before payments are made to staff. This article is only intended to provide an overview of a complicated and high risk area and it is essential to consult with one of our tax experts if you have any concerns in relation to this subject

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## Contact us

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