



Department for
Business, Energy
& Industrial Strategy

Government response to the consultation on tipping, gratuities, cover and service charges

Consultation closed: 27 June 2016

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Any enquiries regarding this publication should be sent to us at: enquiries@beis.gov.uk

Contents

Introduction	4
Background	4
Current treatment of tips, gratuities, cover and service charges	5
Summary of stakeholder responses to the consultation	7
Option 1: Ensure transparency to consumers that discretionary payment for service is 'discretionary'	7
Option 2: Ensure workers receive a fair share from discretionary payments for service	8
Option 3: Increase transparency for consumers and workers regarding the treatment of discretionary payments for service	10
Government response to the consultation	11
Next steps	11

Introduction

Background

There are some 190,000 businesses in the hospitality, leisure and service sectors where tipping is common. These sectors are an important part of our economy, employing over 2 million workers. Concerns have been raised in recent years about employers' treatment of tips, gratuities, and additional payments to workers; and the transparency of such practices to both consumers and workers. There is evidence some employers use practices such as charging excessive administration fees for processing tips or even retaining tips in their entirety. While some businesses have improved practices, there is still concern that other employers continue to make unfair deductions.

The Government has previously worked with industry and worker groups to develop guidance for the treatment of tips, gratuities, cover and service charges. A voluntary Code of Practice was published in October 2009 to improve the information available concerning the treatment of these payments and to increase transparency in this area.

Following new concerns, the Government launched a Call for Evidence on 30th August 2015 to investigate issues raised. This Call for Evidence closed on 10 November 2015.

On 2 May 2016, the Government launched a consultation containing proposals for further action. This consultation closed on 27 June 2016. The consultation stated the Government believes that all discretionary payments for service should be subject to three broad policy objectives, and that tips should be:

- Discretionary – clear to consumers that they are voluntary;
- Received by workers; and
- Clear and transparent to consumers and workers in terms of how the payments are treated.

The Government believes that action is necessary to ensure any future discretionary payments for service meet these policy objectives.

This consultation set out the following options for change to achieve those objectives:

Objective: Ensure transparency to consumers that discretionary payment for service is just that – 'discretionary':

- Option 1A: Ways to ensure businesses make clear discretionary payments for service are just that – voluntary for the consumer;
- Option 1B: Businesses should not be allowed to suggest a particular amount level of discretionary payment for service; and
- Option 1C: Increased transparency regarding cover charges.

Objective: Ensure workers receive a fair share from discretionary payments for service.

- Option 2A: Prevent any employer deduction from discretionary payments for service, except for those required under tax law;
- Option 2B: Limit the deductions from discretionary payments for service an employer can make;
- Option 2C: Ban or restrict the levying of table sales charges on staff; and
- Option 2D: Incentivise and increase the prevalence of well managed tronc systems.

Objective: Increase transparency for consumers and workers regarding the treatment of discretionary payments for service. The consultation proposed options to:

- Option 3A: Update the current voluntary Code of Practice; or
- Option 3B: Place the voluntary Code of Practice on a statutory basis.

Current treatment of tips, gratuities, cover and service charges

There are no specific legal rules regarding the proportion of discretionary payments for service that must go to workers. The relevant legislative frameworks are in place for the National Minimum Wage, Income Tax and National Insurance Contributions (NICs), and tipping practices are also covered by the Consumer Protection from Unfair Trading Regulations 2008. As of 2009, tips cannot be used to count toward National Minimum Wage pay.

The Government's Call for Evidence requested information and views regarding employer practices towards the treatment of discretionary payments for service. Concerns were raised by media reports regarding three key employer practices:

- Charge of administrative fees: Employers charge workers a percentage of discretionary payments for service as a handling charge (usually ranging between 5 – 15% for administrative costs). Often this may be to recoup costs incurred for payroll or other purposes; however there is a concern about the appropriate level that should be charged.
- Employer retains the whole service charge: Alternatively, all of the discretionary payments for service are often retained by the employer. The value of payments retained is often over and above amounts charged to recoup costs incurred by the business.
- Workers required to pay back a percentage of table sales: Reports suggests some employers raise a sales charge based on the sales a member of staff makes during a shift (ranging from 3% to 5.5%) rather than the discretionary payments for service received. Waiting staff are required to pay such a fee, which the business expects to be paid from the discretionary payments for service collected during a shift (and if these don't cover the charge, they must pay them from the subsequent shift). Employers have provided evidence to indicate that this rate goes towards non-waiting staff as a form of

pooling as well as staff food and drink, recruitment, training, team activities, rewards and development.

Analysis of responses to the Call for Evidence indicated confusion about the rules relating to tipping and other charges. There are currently a number of terms used to describe ways in which consumers make such payments:

Voluntary payments:

- **Tips and gratuities:** A sum of money given in recognition of an individual's service provided, in addition to what is required of the consumer in a contract. This should usually be freely given (without claim or demand) and over and above a payment due for a core service (i.e. the price of menu items).
- **Service charge:** An amount which the business suggests to the consumer on a bill (often suggested as a percentage of the consumer's bill). The consumer is free to make the payment or not, however the Call for Evidence suggests consumers are unaware of this and feel obliged to pay the suggested amount. There is no current legal requirement for employers to pass on any of the service charge, in full or part, to the workers. Many workers do not benefit from this directly, and its presence on a restaurant bill puts off many diners from leaving any other discretionary payment for service.

There are two mechanisms by which consumers can make these voluntary payments:

- **Cash:** Discretionary payments for service paid by means of cash payments are payments which a worker usually receives directly from a consumer. They belong to the worker and it the worker's responsibility to inform HMRC for tax purposes. National Insurance Contributions (NICs) will not be due on such payments.
- **Card:** Discretionary payments for service paid by means of card payments are paid directly to and belong to the business - but they can choose to pass any amount onto to the worker. It is the employer's responsibility to ensure any proportion of the payments that is passed on to the worker is included in PAYE calculations in respect of any income tax and NICs liabilities that may exist. However, where a tronc scheme is in place and the troncmaster is someone separate to the employer and the employer has no involvement in how the money is distributed, the troncmaster is responsible for operating and paying over the PAYE tax.

Mandatory payments:

- **Cover charge:** A charge that any consumer must pay in addition to payment for the core service (i.e. the price of menu items). This is usually a price per head, is mandatory and should be stated on tariffs and menus. A consumer will choose whether to use the service with knowledge of this charge being applied. Many workers do not benefit from this directly; furthermore, its presence on a restaurant bill puts off many diners from leaving a tip or gratuity.

Summary of stakeholder responses to the consultation

A total of 173 responses to the consultation were received. Of these, the majority (126, or 73%) were customers of businesses where tipping takes place. The remainder were employers or businesses where tips or gratuities were made (17 respondents), workers who receive or collect tips (6 respondents), or other respondent groups (24).

Most (148, or 86%) respondents completed the consultation as individuals, with the remaining 24 responding on behalf of an organisation, including trade unions and business representative organisations.

Option 1: Ensure transparency to consumers that discretionary payment for service is ‘discretionary’

The first set of options presented intend to achieve the objective of ensuring transparency to consumers that a discretionary payment for service is in fact discretionary. A consumer can ask for an automatically added service charge to be removed, but it is not always clear that the consumer has a choice. A number of different tipping practices exist, which can lead to confusion for consumers. Responses to our Call for Evidence showed consumers wanted clarity about discretionary payments for service.

The options were:

Option 1A: Any suggestion of a discretionary payment for service must emphasise that this is discretionary for the consumer.

Option 1B: Prevent businesses from suggesting any specific amount of discretionary payment for service.

Option 1C: Increase transparency regarding cover charges.

Overall, responses were mixed on these three options, with a small majority of all respondents believing that Option 1A (60%) and/or Option 1B (57%) would best ensure that discretionary payments are seen as voluntary. Slightly under half of respondents (44%) believed that Option 1C would be most effective.¹

A relatively small proportion (14%) of respondents believed Option 1A would not go far enough and 6% said that 1B is too strong. Both of these options were not believed to impose high cost on business.

¹ Note that 5% of respondents did not respond and those that did could choose more than one option and therefore percentages do not sum to 100%

When asked whether these options would affect the ability of consumers to make payments by card, the majority of respondents felt this would not be affected.

The consultation asked respondents to suggest any other options to ensure transparency to consumers than voluntary payments are discretionary. A clear explanation that additional payments are voluntary was the most favoured response (24) (though this also reflects option 1A). Other respondents to this question favoured stopping suggested payments being included on the final price (16%), banning suggested service charges altogether (12%) and providing clearer explanations of who will receive discretionary payments (8%).

Respondents were split on whether regulatory frameworks are appropriate to enforce emphasis that discretionary payments are in fact optional, with 46% answering 'no', and 40% answering 'yes' (14% did not answer). When asked what additional enforcement measures they would suggest, the most heavily suggested additional measure proposed was to ban service charges (13%).

Option 2: Ensure workers receive a fair share from discretionary payments for service

The second set of options were to achieve Government's objective to ensure workers receive a fair share from discretionary payments for service. The Call for Evidence made it clear consumers wish for their discretionary payments for service to be received by workers. It also showed consumers do not understand the reasons an employer might make deductions from discretionary payments, which vary from covering payroll and credit card processing costs, staff food and drink, recruitment and training, and more. Responses to the Call for Evidence also showed support for restrictions on employer involvement in the processing of discretionary payments for service. The majority of employers were not sure they followed the current guidelines correctly.

The Government believes that all discretionary payments for service, after tax where appropriate, should be received by the worker; or managed separately from the employer through a tronc system.

The options were:

Option 2A: Prevent any employer deduction from discretionary payments for service, except for those required under tax law.

Option 2B: Limit the deductions from discretionary payments for service an employer can make.

Option 2C: Ban or restrict the levying of table sales charges on staff.

Option 2D: Incentivise and increase the prevalence of well managed tronc systems.

Almost 70% of respondents favoured preventing any employer deductions from discretionary payments, supporting Option 2A, though employers were far less likely to support this (24%). The next most favoured response was Option 2C – to ban or restrict the levying of tables sales chargers on staff (51%).

When asked to suggest any other options to ensure workers receive a fair share from discretionary payments for service, suggestions included that the use of tronc systems and the Government not taxing tipping revenue. Answers also supported a preference for banning employer involvement, including deductions.

Respondents were asked to provide evidence to explain whether current handling deductions vary depending on the amount of discretionary payment for service, or carry a percentage charge. Responses indicated that banking charges from various providers (credit card and cash deposit fees) varied as a percentage of the amount of the total bill, including discretionary payments received, and that payroll providers and independent troncmasters may charge fees based on the number of transactions (employees in the tronc), but it is possible that independent troncmasters will charge a set fee which considers the average value of discretionary payments and the number of employees.

Employers were asked to provide evidence of the cost to them of handling discretionary payments for service for tax purposes, however fewer than 10% of respondents gave a specific answer to Question 15 and as such findings are inconclusive.

When asked if they agreed with proposed updates to the E24 tronc guidance, nearly half of respondents (47%) did not answer, with 31% agreeing with the proposed updates and 23% disagreeing.² Some respondents (12%) indicated that the proposed updates were too complicated, and others (9%) indicated that they were unaware of the guidance or disagreed with the updates. A smaller proportion stated that the guidance is clear and fair (7%). Respondents were in clear favour of placing tronc requirements on a statutory footing (45%), with 24% stating that guidance should only be updated (32% did not respond).

Respondents were split on whether the current regulatory frameworks are appropriate to enforce proposals to ensure that workers receive a fair share from discretionary payments for service. Of all respondents, 36% indicated current regulatory frameworks are not appropriate and 29% indicated they are. Only 17% of respondents answered the question on what additional enforcement measures they would suggest. Of these responses, over half were in favour of legislating on the transparency and/or treatment of tipping practices.

² Note percentages do not sum to 100% due to rounding

Option 3: Increase transparency for consumers and workers regarding the treatment of discretionary payments for service

The third set of options was to increase transparency for consumers and workers regarding the treatment of discretionary payments for service. Currently a voluntary Code of Practice provides guidance to employers on how to ensure practices are transparent, however evidence shows that the Code of Practice is not widely used or understood, and consumers and employees thought it does not provide a fair and transparent process.

The two options were:

Option 3A: Update the voluntary Code of Practice

Option 3B: Apply a statutory Code of Practice

Respondents to the consultation supported Option 3B – to apply a statutory code of practice – by a majority (61%), with 19% believing that updating the voluntary guidance was the best option (20% did not answer). Customers (67%) and workers (50%) were far more likely to support a statutory Code of Practice than employers (29%).

Responses also suggested that the voluntary Code alone would be insufficient to ensure transparency for consumers and ensure that workers receive their fair share of tips, citing that it has not worked in the past and enforcement would be required moving forward.

The costs of complying with the voluntary Code of Practice commonly outlined by respondents were those to run an effective tronc system, which are primarily the staff time required to set the allocation, process payments and distribute. The costs are generally not considered to be great and there is limited evidence of additional costs of a tronc beyond those that would be incurred distributing tips through another mechanism.

Employers were asked if they estimated any additional costs in complying with the suggested changes to the voluntary Code of Practice. Of the employers who responded, 53% told us they would estimate additional costs in adhering to the suggested voluntary Code, with 29% telling us that they would not (18% did not respond). Three responses anticipate additional costs of increasing transparency around tronc systems and being obliged to produce annual statements (stating the value of discretionary payments collected, how they are handled and deductions made). The costs mentioned would primarily be in the form of additional staff time.

Government response to the consultation

It is clear from feedback that the current guidance and rules are not sufficient to achieve the Government's objectives.

Consumers need to be able to understand the charges on their bill, their options for making discretionary payments to reward good service, and they need to have confidence that payments they make will be fairly passed on to workers. Feedback strongly supports transparency for consumers on discretionary payments and that they are to be freely given. We want to make sure customers understand the upcoming changes to the law so they can be confident their tips will be treated properly.

Stakeholders support Government's objective that workers receive their fair share of discretionary payments. This fact should be clear to consumers making tips and to workers receiving tips. The current voluntary Code of Practice demonstrates how employers should pass on tips to staff, whether paid in cash or by card, but evidence shows this is not happening across the sector. This Government strongly believes workers should receive tips in full, without any employer deductions.

The current voluntary Code of Practice was introduced in 2009 to increase transparency to employers about how to handle discretionary payments for service. Evidence shows this guidance is not used widely and therefore it alone is insufficient to ensure transparency in how tips are treated and that staff receive their fair share of tips. Any new statutory guidance will need to be managed to be sure it does not pose a burdensome cost on business.

While some businesses have changed their practices since the consultation ran, others continue to unfairly retain monies intended for their workers and be opaque about their practices to their customers. As we recover from the current economic crisis, it is important to ensure some unscrupulous employers do not gain a competitive advantage over others, and that consumers continue to have confidence in service industries.

Next steps

Based on this evidence, Government announced in 2018 the intention to legislate to ensure tips left for workers go to them in full, ensuring they get the tips they deserve and giving customers reassurance.

We will bring forward measures to ensure tips, gratuities and service charges go to workers in full as part of an upcoming Employment Bill.

These legislative measures will include:

- Requirements for employers in all sectors to not make any deductions from tips received by their staff, including admin charges, other than those required by tax law.

- Requirements for employers to distribute tips in a way that is fair and transparent, with a written policy on tips, and a record of how tips have been dealt with. Employers will be able to distribute tips via a tronc, and a tip must be dealt with no later than the end of the month following the month in which it was paid by the customer.
- Provisions to allow workers to make a request for information relating to an employer's tipping record. Employers will have flexibility how to design and communicate a tipping record, but should respond within four weeks.
- Requirements for employers to have regard to a statutory Code of Practice on Tipping.
- Where employers fail to comply with these measures, this will be enabled through Employment Tribunal.

The Employment Bill will be brought forward when Parliamentary time allows. We expect these rules to commence no earlier than one year after the Bill has passed.

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