

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

**A guide to:**

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

## Help and guidance

You can get help and guidance from the following sources.

### The internet

For help with your payroll, go to [www.gov.uk/business-tax/pay](http://www.gov.uk/business-tax/pay)

For wider interactive business help, go to [www.gov.uk/starting-up-a-business](http://www.gov.uk/starting-up-a-business)

Webinars are a new way of learning about your payroll. Our presentations cover a wide range of topics. For more information, go to [www.gov.uk/government/collections/hmrc-webinars-email-alerts-and-videos](http://www.gov.uk/government/collections/hmrc-webinars-email-alerts-and-videos)

Any page printed from the online version of this helpbook is uncontrolled and may not be the latest version. We recommend that you always check you are referring to the latest online version.

### Online services

For information and help using our Online Services, go to [www.gov.uk/log-in-register-hmrc-online-services](http://www.gov.uk/log-in-register-hmrc-online-services)

For more help, contact the Online Services Helpdesk by:

- phone on **0300 200 3600**
- textphone on **0300 200 3603**

### Basic PAYE Tools

The Basic PAYE Tools is software that you download onto your computer. It will help you run your payroll throughout the year. It is designed for employers who have 9 or fewer employees, and you can use it to calculate payroll deductions and then report payroll information online in real time.

Basic PAYE Tools will:

- record your employees' details
- work out and record your employees' pay, tax, National Insurance contributions (NICs) and any Student Loan deductions every payday
- enable you to claim your NICs Employment Allowance (up to £2,000 per year off your Secondary Class 1 NICs liability)
- generate the payroll data that you need to send to HMRC in real time, including starter and leaver information
- produce an Employer Payment Record that works out how much you need to pay HMRC
- contain calculators to help you to work out statutory payments such as Statutory Sick Pay and Statutory Maternity Pay

You can find more information about the Basic PAYE Tools at [www.gov.uk/payroll-software](http://www.gov.uk/payroll-software)

### Employer helplines

- Employer for less than 3 years, phone **0300 200 3211**
- Employer for 3 years or more, phone **0300 200 3200**
- If you have a hearing or speech impairment and use a textphone, phone **0300 200 3212**

Please tell us your employer PAYE and Accounts Office references when you contact us. You will find them on correspondence from HMRC.

### Employer helpbooks and forms

Helpbooks and forms are available to download. Go to [www.gov.uk/government/collections/payroll-publications-for-employers](http://www.gov.uk/government/collections/payroll-publications-for-employers)

### Yr Iaith Gymraeg

I lawrlwytho ffurflenni a llyfrynnau cymorth Cymraeg, ewch i [www.gov.uk/government/collections/ffurflenni-cthem](http://www.gov.uk/government/collections/ffurflenni-cthem) a dilyn y cysylltiad i Becyn Cyflogwr. Os, yn eithriadol, nad oes gennych gysylltiad i'r rhyngwrdd, cysylltwch â'r Ganolfan Gyswllt Cymraeg ar **0300 200 1900**.

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

For details of employer forms and guidance in Braille, large print or audio, phone the Employer Orderline on **0300 123 1074** and ask to speak to the Customer Service Team.

### Education services from the Digital Delivery Team

Find out more about our webinar programme at [www.gov.uk/government/collections/hmrc-webinars-email-alerts-and-videos](http://www.gov.uk/government/collections/hmrc-webinars-email-alerts-and-videos) and why not take a look at our Youtube channel? You can view our video clips or listen to a recorded version of our webinars. Go to [www.youtube.com/user/HMRCgovuk](http://www.youtube.com/user/HMRCgovuk)

### Employer Bulletin online

Employer Bulletins contain information and news for employers. We publish these several times a year. Go to [www.gov.uk/government/collections/hm-revenue-and-customs-employer-bulletin](http://www.gov.uk/government/collections/hm-revenue-and-customs-employer-bulletin)

### Employer email alerts

We strongly recommend that you register to receive employer emails to prompt and direct you to:

- each new edition or news about the Basic PAYE Tools
- the Employer Bulletin
- important new information

To register, go to [www.hmrc.gov.uk/payerti/forms-updates/forms-publications/register.htm](http://www.hmrc.gov.uk/payerti/forms-updates/forms-publications/register.htm)

### HM Revenue & Customs (HMRC)

If you have a query about your PAYE scheme:

- phone the Employer Helpline on **0300 200 3200**
- write to  
HM Revenue & Customs  
National Insurance Contributions & Employer Office  
BP4102  
Chillingham House  
Benton Park View  
NEWCASTLE UPON TYNE  
NE98 1ZZ

Please tell us your employer PAYE and Accounts Office references when you contact us. You will find them on correspondence from HMRC.

### Your rights and obligations

'Your Charter' explains what you can expect from us and what we expect from you. For more information, go to [www.gov.uk/government/publications/your-charter](http://www.gov.uk/government/publications/your-charter)

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## 1 Introduction

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

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

## 2 Overview

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

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

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

## 3 Definitions

### Tip/gratuity

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

### Service charge

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

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

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

### Tronc

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

### Troncmaster

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

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

## 4 VAT

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

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

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

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

More information is available from: Notices 700 'The VAT guide' and 709/1 'Catering and takeaway food'. Go to [www.gov.uk/government/collections/vat-notice-numerical-order](http://www.gov.uk/government/collections/vat-notice-numerical-order) or contact the HMRC VAT & Excise helpline on **0300 200 3700**.

## 5 Income Tax

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

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

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

There may be arrangements:

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

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

Guidance on the operation of PAYE can be obtained from the GOV.UK website:

- employer helpbook CWG2 'Employer Further Guide to PAYE and NICs' - [www.gov.uk/government/publications/cwg2-further-guide-to-payee-and-national-insurance-contributions](http://www.gov.uk/government/publications/cwg2-further-guide-to-payee-and-national-insurance-contributions)
- PAYE and payroll for employers - [www.gov.uk/payee-for-employers](http://www.gov.uk/payee-for-employers)

- Rates and thresholds for employers 2015 to 2016 - [www.gov.uk/rates-and-thresholds-for-employers-2015-to-2016](http://www.gov.uk/rates-and-thresholds-for-employers-2015-to-2016)
- Payroll: annual reporting and tasks - [www.gov.uk/payroll-annual-reporting](http://www.gov.uk/payroll-annual-reporting)

#### Example 1

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

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

#### Example 2

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

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

## 6 Income Tax and tronc

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

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

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

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

#### Example 3

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

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

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

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

#### Example 4

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

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

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

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

#### Example 5

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

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

## 7 National Insurance contributions (NICs)

Legislation provides that any amount paid to an employee which is a payment 'of a gratuity' or is 'in respect of a gratuity', is exempt from NICs if it meets either of the following 2 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

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

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

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

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

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

you should contact HMRC for advice.

#### Example 6

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

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

#### Example 7

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

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

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

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

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

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

#### Example 8

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

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

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

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

## 8 National Insurance contributions and tronc

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

Payments of tips do not attract NICs if the:

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

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

#### Example 9

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

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

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

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

#### Example 10

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

Even though Frank has appointed Sharon as troncmaster he has played no part, directly or indirectly, in the allocation of the tips because he is not involved in determining who should receive tips and how much each employee should receive. In these circumstances, no NICs will be due on the tips received by the tronc members.

#### Example 11

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

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

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

#### Example 12

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

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

#### Example 13

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

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

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

#### Example 14

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

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

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

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

#### Example 15

Bruno and Antonio run a restaurant. The tips are paid from a tronc run by Dino. The other employees elected him. He decides who will participate in the tronc arrangements and how much each participant will get. Dino has chosen to restrict tronc membership to those who have worked in the restaurant for a minimum of 6 months.

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

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

## 9 National minimum wage

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

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

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

## 10 Reviews of records

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

## 11 Legislation

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

For NICs purposes the legislation relating to 'gratuities and offerings' which can be disregarded from liability when calculating earnings is contained at paragraph 5, Part 10, Schedule 3 of the Social Security (Contributions) Regulations 2001 (S.I. 2001 No. 1004).

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

## 12 National Insurance contributions: treatment of tips

