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Chartered Accountants

# A QUICK GUIDE TO **TIPS AND GRATUITIES**

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## In a bid to protect workers and boost retention in hospitality sectors, the Government is introducing new legislation on the way that tips from consumers are collected and distributed by employers.

The Employment (Allocation of Tips) Act 2023 exists “to ensure that tips, gratuities and service charges paid by customers are allocated to workers” – and will affect almost every aspect of the sector.

This landmark legislation, which received Royal Assent on 2 May 2023, is set to take effect from 1 July 2024.

Its overarching aim is to ensure fair and transparent distribution of tips across the roughly two million workers within the industry in the UK – returning around £200 million to the hands of employees, according to Government estimates.

This is a brief guide as to how you will be required to manage tips and gratuity and steps you can take to ensure compliance with new regulations.



# What does the Act actually say?

**At the core, this legislation makes it illegal for employers or hospitality establishments to withhold tips from workers.**

It is currently a widespread practice across certain operators in the sector for employers to cover certain costs using a proportion of tips paid by customers – a practice which drove the initial consultation on the legislation in 2016.

One of the key clarifications that the new Act makes is a protection for tips paid by card or contactless payment.

Cash payments have been protected for a while, but card payments often have card charges or other operational costs deducted before being passed on.

New regulations will outlaw this.

The Act also requires businesses to keep records of all tips received and distributed in the event that an employee wishes to launch a Tribunal claim.

Significantly, this legislation also sets out a clear differentiation between voluntary customer tips and service charges that businesses often add to bills by default.

Employers must now distribute all tips, without unfair deductions, directly to their employees (obviously, taking into account only the necessary tax withholdings).

## Tax deductions

Employees must pay Income Tax on all tips they receive.

Tips and gratuity paid through their employer usually come under the Pay As You Earn (PAYE) system, meaning tax is deducted at source alongside tax on normal pay.

This is permitted and required under the Act if done by the troncmaster.

Under a tronc scheme, tips are subject to a National Insurance exemption – meaning they can also offer significant savings over other methods of gratuity distribution.

## Are all employees covered by the Act?

Yes

The hospitality sector relies more heavily on zero-hours and seasonal workers than certain other sectors, so there can be some confusion over whether workers are entitled to tips.

The Act clarifies that all workers, whether permanent or temporary, fixed or zero hours, are entitled to a fair proportion of tips paid over a certain period.

You must make a record of tips paid to all staff, regardless of their contract type.

# Government initiatives and the Code of Practice

In anticipation of these changes, the Government has unveiled a draft Code of Practice.

Although it is still undergoing consultation, the Code is designed to flesh out the Act's requirements, offering guidelines to businesses for fair tip allocation and ensuring employees understand their rights through further information and education.

It covers several critical areas:



**Scope and definitions:** It clarifies what constitutes a “tip” and outlines acceptable payment methods.



**Fairness in distribution:** The Code encourages employers to consider various factors, such as employee performance and customer intent, to ensure equitable tip allocation.



**Transparency requirements:** Employers are now required to develop and share a documented policy on tip distribution with their employees, detailing the allocation process and adherence measures.



**Dispute resolution:** It stipulates the establishment of fair procedures for handling tip distribution disputes, applicable to both direct and agency workers.



**Terminology:** A glossary section is included to demystify terms used within the Code, such as “basic pay” and “agency worker.”

# A note on fairness

As previously mentioned, 'fair distribution' does not necessarily mean equal distribution.

Employers and troncmasters are asked to consider multiple factors under the Act, including:



**Customer intention** – Sometimes, a customer wants the tips they pay to go to a specific person or group who have provided them with excellent service.



**Hours worked** – You may choose to divide tips based on the number of hours worked in a given pay period.



**Seniority** – More senior staff members or those with additional responsibilities may receive a higher amount in tips than junior employees.



**Length of service** – You may choose to reward length of service with an increased proportion of tips.



**Performance** – If someone on your team has particularly excelled or managed a difficult shift, you may feel that it is fair to distribute a higher percentage of collective tips to them.

You must have clear reasons for why you have chosen to distribute tips in the way that you have – otherwise, you could face a Tribunal.

# Understanding the tronc system

The Act requires that, rather than you as an employer collecting tips and distributing them, you must set up a dedicated pot, called a tronc.

A tronc is an arrangement into which all tips and gratuities are paid.

Once all tips have been paid in for a specific period, they are then distributed fairly among the staff.

Tips and gratuity are paid directly into a tronc and employers are not allowed to make deductions before doing so.

Troncs are managed by troncmasters – a nominated person within your organisation who is responsible for managing how the tronc works and distributes money to employees.

Troncmasters are often required to run payroll and report to HM Revenue & Customs (HMRC).

The goal of a tronc is to be genuinely independent of established management or ownership to ensure fairness in distribution.

# What are the implications for your hospitality business?

Businesses that withhold tips from their employees are the subject of much public chagrin and dissatisfaction when they are found out and the Act will now add a legal aspect to this.

It also reflects a broader move towards a cashless society and the decrease in cash use since the pandemic.

It also introduces specific obligations for employers:

**All tips must be allocated to employees, with only tax exceptions.**

**Employers are required to communicate their tipping policies to their workforce.**

**Accurate records of tip distribution must be maintained.**

Employees, in turn, are empowered to request their tip distribution records, enhancing their ability to seek recourse through employment tribunals if needed.



# Strategic adjustments to support compliance

You will need to set up a compliant tronc scheme before the new regulations come into effect.

This includes deciding how to fairly distribute tips amongst your workers.

For example, you might divide tips equally between each staff member, or calculate how many hours each person has worked and distribute a percentage of tips depending on this figure.

If you currently cover certain costs with a percentage of tips provided to your employees, you will need to stop doing this and consider the immediate impact on your cash flow.

You'll need to develop and implement formal policies that detail the fair distribution of tips amongst your workers.

Moreover, you will need to keep detailed records for three years and ensure the inclusion of agency workers in the distribution process.

Failure to comply could lead to Employment Tribunal claims and financial penalties so it is important to speak to an expert in employment law as soon as possible.

# Contact us

**We can help you understand your responsibilities, obligations and rights under this new legislation and ensure you remain compliant.**

This guide is a brief overview of your new obligations under the Act. For more detailed information tailored to your circumstances, please get in touch with us.

**If you would like assistance with the management of your payroll in relation to the changes introduced by the Employment (Allocation of Tips) Act, please contact us.**

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