

**Tips, gratuities, cover and service charges: proposals for further action**  
**Department for Business, Innovation and Skills (BIS) consultation document**  
**Response from the Low Incomes Tax Reform Group (LITRG)**

**1 Executive Summary**

- 1.1 Tips are an important source of income for many low-paid workers, particularly in the hospitality sector. We are writing this response on behalf of this group of, often vulnerable, workers and welcome the launch of this consultation document on tackling questionable employer practices and making the tipping process fairer and more transparent.
- 1.2 The focus of our response relates mainly to the area of tronc as this is within our interest and expertise. We broadly support a programme designed to incentivise and increase the prevalence of well managed tronc systems. We believe this could certainly help improve many workers' positions, not least because if operated correctly, tips will not attract a Class 1 National Insurance Contributions (NIC) liability – offering a saving to the worker.
- 1.3 This is on the proviso that any impact to workers' National Insurance records of having a greater proportion of NIC free tips, is something that will be carefully considered before any action is taken.
- 1.4 It should be noted, that setting up and running a tronc correctly, following HM Revenue & Customs (HMRC) requirements, is a labyrinthine issue – something that is not addressed in the consultation document. In essence, the tronc must operate completely independently of the employer, which in practice, can be difficult. Indeed, it is so complicated that a whole industry has sprung up offering troncmaster services. As things stand, we are concerned that troncs may not always offer the solution to workers that BIS hopes.
- 1.5 We think that a tronc should be something that staff members can set up and run themselves without undue administrative burden. In order to achieve this, BIS and HMRC need to work together

to ease the process for troncmasters – this may be by simplifying the rules and/or by providing much clearer guidance.

- 1.6 Provided the current barriers can be dealt with, we think that more should be done to encourage *cash* tips to be put into the tronc system so that PAYE tax can be operated. The current rules on cash tips mean that it is the workers' responsibility to declare them to HMRC. In reality we think this means that they go largely un-taxed. Whether intentional or not, non-declaration can leave workers in difficult situations. We appreciate that PAYE tax at source may initially be unpopular amongst workers, however we would hope that – with the right awareness raising communications – they could be persuaded that it is preferable to falling foul of HMRC's compliance function later down the line.
- 1.7 Failing this, as tax is often used to encourage certain behaviour, we wonder if a small tronc tax break might help (and indeed whether such a move might help the Department for Business, Innovation & Skills (BIS) achieve its aim on troncs more generally).
- 1.8 Finally, we take the opportunity to call for a broader review of the tax and NIC rules surrounding tips and would urge BIS to work with HMRC towards this longer term aim. We have previously commented on the complexity that arises due to the differing tax and NIC treatment of tips depending on whether the customer leaves one on the table or it is distributed by the employer or via a 'tronc' system. We feel that this current lack of fairness and transparency around the current rules, leaves low paid workers feeling confused and disenfranchised. A simpler system overall could help improve their understanding enormously and encourage general compliance with the law.

## 2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

## 3 Our approach

- 3.1 **Tips are an important source of income for many low-paid workers, particularly in the hospitality sector.** We welcome the launch of this consultation document on making the tipping process fairer and more transparent.

- 3.2 In our response we have not addressed each individual question as many cover topics outside our field of knowledge. However the consultation asks how well-managed tronc schemes can be encouraged and we feel we can make a useful contribution to this question by providing some broad comments on the tax and NIC treatment of tips and trons which we feel are relevant and which we hope will inform the government's next steps.
- 3.3 For information, our comments are drawn from the experiences of members of the public who have contacted us or our colleagues at TaxAid<sup>1</sup> – a charity offering up-to-date information and advice on tax matters to individuals on low incomes who cannot afford professional advice – for help with problems they have experienced with tips and trons.

#### 4 Trons

- 4.1 **We think that incentivising and increasing the prevalence of well managed tronc schemes could certainly help improve many workers' positions.** Provided the troncmaster is trustworthy, reliable, and impartial, we would agree that a tronc can help mitigate the opportunity for poor practices around tips. In addition, if it is operated correctly, then tips passed on to employees by the troncmaster will not attract a Class 1 NIC liability – offering a saving to the worker.
- 4.2 **Saying that, we have a slight reservation as to whether there will be any knock on effects to workers' National Insurance records.** This is an industry where many people are on zero hours contracts, working casually, or part time and a large segment of their income may be from a tips. If a greater proportion of tips are NIC free, and ordinary earnings are not sufficient to keep them above the Lower Earnings Limit,<sup>2</sup> then workers could lose entitlement to the state pension and other contributory benefits. While income-based alternatives to contributions-based benefits might be available or indeed, National Insurance credits (available when receiving various benefits – including working tax credit or child benefit), to help restore entitlement to the state pension and benefits, we assume that this is something that will be carefully considered before any action is taken.
- 4.3 **In addition, setting up and running a tronc correctly, in accordance with HMRC requirements, is a labyrinthine issue for the member of staff who has essentially taken it on voluntarily.** This is not addressed in the consultation document.
- 4.4 Many waiters, waitresses and other workers in the hospitality industry are young, with lower levels of experience, or indeed education or literacy. They may also be migrants, many of whom may be new to the UK or have English as a second language. All of these people are likely to have extremely limited or indeed no real understanding of the UK tax system.
- 4.5 We think it is important to see the situation from their perspective then, when reading HMRC's guidance, such as at PAYE20160<sup>3</sup> which says:

'To enable you to accept that a tronc exists for tax purposes there must be evidence that there is an organised arrangement and a person who accepts that they are the troncmaster.'

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<sup>1</sup> [www.taxaid.org.uk](http://www.taxaid.org.uk)

<sup>2</sup> £112 per week in 2016/17

<sup>3</sup> <https://www.gov.uk/hmrc-internal-manuals/payee-manual/payee20160>

Ascertain the following<sup>4</sup>:

- How monies are received by the tronc
  - Do employees pay cash tips in
  - Does the employer hand over tips etc. included in cheque or card payments
  - Does the employer hand over service charges
- Who keeps the monies before distribution
- Where the money is kept
- The basis of distribution and who decides it
- ...
- How often the monies are shared
- The extent of the principal employer's involvement, if any
- Which staff are covered by the tronc
- Whether the staff are aware of the tronc and the troncmaster
- Whether the person identified as the troncmaster accepts and understands the position'

4.6 HMRC then go on to say:

'Where you establish that a tronc exists for tax purposes

- ...
- Arrange for a member of the Business Support Team (BST) to
  - Visit the troncmaster
  - Explain their responsibilities under the PAYE regulations
  - Supply the necessary forms and tables'

4.7 In Booklet E24 'Tips, gratuities, service charges and tronc',<sup>5</sup> HMRC say:

'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.'

4.8 In addition, we now have the Real Time Information (RTI) payroll reporting system and all the considerations that this brings, for example obtaining RTI start checklists (or equivalent) and submitting a Full Payment Submission (FPS) on or before payments of tips are made. Furthermore, under a tronc, tax may be deducted from distributed tips at a flat 20% rate, meaning that many staff either overpay or underpay tax in a year. This potentially leaves troncmasters facing ongoing questions from disgruntled workers.

4.9 Bearing all of this in mind, we think that running a tronc would be an extremely daunting and difficult prospect for most people, let alone a head waiter or waitress who may have no real knowledge of the tax system. We do not think this is the correct backdrop against which to encourage the use of tronc!

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<sup>4</sup> We assume, from the troncmaster

<sup>5</sup> <https://www.gov.uk/government/publications/e24-tips-gratuities-service-charges-and-troncs>

- 4.10 Furthermore, due to everything involved and the huge amount of responsibility piled on the troncmaster, as we understand it there are currently two ‘workarounds’ in use:
- The employer stands in as payroll agent and makes the calculations for the troncmaster
  - The employer seeks the services of a professional external troncmaster
- 4.11 Neither of these workarounds are ideal. In the first instance, there is a risk that this integrates the operation of the tronc more closely with the employer, compromising the independence of the tronc and its special NIC free status. It also provides unscrupulous employers with the opportunity to levy admin fees for their ‘assistance’ (which may or may not go further than actually recouping their costs). Furthermore if something goes wrong, it seems it would be very easy for employers and troncmasters to blame each other, making it more likely that HMRC will pursue the path of least resistance by recovering any underpayment from the employee. This is contrary to HMRC’s own regulations but is nevertheless common practice for them.
- 4.12 In the second instance, one just has to check the internet for ‘troncmaster service’ to see there are a number of options available. However the downside of an external provider is that they will charge for their services, the cost of which will no doubt be borne out of the staff tip income.
- 4.13 We do not imagine that these types of outcomes are what BIS contemplates when they say they want to encourage the use of more troncs. We hope that BIS would agree that, ideally, running a tronc should be something that staff members can do themselves without undue administrative burden. It should be easy for them to understand, act in accordance with their payroll responsibilities and manage in practice.
- 4.14 **In order to achieve their aim of incentivising the use of a tronc system ‘which is wholly independent from employers’ we would suggest that BIS and HMRC need to work together to ease the process for the troncmaster from a tax and NIC perspective.** There are several things that could be done – the HMRC rules around when a tronc is ‘compliant’ could be simplified, a less onerous system of payroll reporting could be put into place, protections could be extended to troncmasters in fulfilling their role and so on.
- 4.15 These measures could be supplemented by better guidance for troncmasters, as alluded to on page 17 of the consultation document. Any new guidance however, needs to be clear, user-friendly and properly targeted. We are not sure that booklet E24 should be the starting point. The style of using increasingly convoluted examples (15 of them) to explain the current system is difficult to follow even for qualified tax professionals. Moreover it seems to be currently aimed at employers.
- 4.16 **Provided the current barriers can be dealt with, we think more should be done to encourage staff to pool their cash tips into a tronc.** Under current rules on cash tips, it is the workers’ responsibility to declare them to HMRC. In reality we think this means they go largely un-taxed. Whether intentional or not, this can leave workers in difficult situations as we go on to explain.

## 5 Cash tips

- 5.1 If a waiter gets cash tips directly from a customer without involving the employer, they have to pay tax on them, but not NIC. They are responsible for telling HMRC about these tips and have to keep a contemporaneous record of what they have received, in order to be able to do this. They have to

show tips received on their Self-Assessment tax return (if they fill one in). If they do not, as is more likely, HMRC estimate the tips they are likely to get and give them a tax code that will collect the tax through PAYE.

- 5.2 In reality, we do not think that accurate declarations about the amount earned as tips are always being made – maybe accidentally, maybe not. There is a lack of clarity around tips and tax in general (as we discuss later) and the worker may quite innocently not realise they should be declared. Additionally, it should also be noted that even if workers are minded to do the right thing, information on GOV.UK<sup>6</sup> seems to imply that HMRC may get the information about cash tips from the employer, which is probably incorrect in the vast majority of cases, meaning that HMRC may not get the information it requires in any case.
- 5.3 This can potentially lead to many problems for workers later down the line. If tips come under HMRC scrutiny, compliance action could leave workers in a very difficult situation and owing a large sum of money – particularly as HMRC can go back up to four previous years for underpayments. Tax credits are another consideration. HMRC now uses the information provided on RTI PAYE submissions to calculate and pay any tax credits employees are entitled to. If there is no visibility over cash tips, and unless workers declare them themselves, it is possible that many may also be receiving inflated tax credit awards, which could result in recoverable overpayments and possibly a penalty.<sup>7</sup>
- 5.4 Finally, for those that do declare their tips and pay tax via a tax code adjustment, the situation is still less than ideal. The PAYE coding facility for expenses is not known to work well – particularly in the context of many changes of circumstances, which low-paid employees often have. Codes can be fiendishly complicated to understand and check and because tax can only be collected on an estimated basis, this can lead to problems in its own right.
- 5.5 Taking all of these things into account, we feel that many of the problems we have highlighted could be avoided if more is done to encourage staff to pool their cash tips into a tronc and have PAYE tax deducted at source. We understand that because it would take longer for workers to get their money and there would be less up front, such a move may initially be unpopular. We would hope however, that with the help of an appropriate awareness raising exercise that explains how this will ensure a more consistent outcome between workers/prevent them falling foul of HMRC's compliance function etc., they could be persuaded.
- 5.6 **Failing that, as tax is often used to encourage certain behaviour, we wonder if a small tax break might help encourage staff to pool their cash tips into a tronc (and indeed whether this might help BIS achieve its aim of encouraging troncs more generally).** While the Government are generously handing out tax free 'allowances', such as those for savings income, dividends and from next year – income from the 'sharing economy' – perhaps they could be persuaded to help some of the lowest paid members of society and carve out an exemption for a certain 'de minimis' level of tip income, provided it is run through a tronc.

## 6 Transparency and fairness

<sup>6</sup> <https://www.gov.uk/tips-at-work/tips-and-tax>

<sup>7</sup> Tax credit claimants will eventually be migrated across to Universal Credit (UC) which will replace income-based Job Seekers Allowance, income-based employment and support allowance, income support, child tax credit, working tax credit and housing benefit. The RTI PAYE system feeds into UC, meaning that similar overpayment situations are likely to occur.

- 6.1 We note that words fairness and transparency run throughout the consultation documents – these are concepts that we obviously support. However, what is not fair or transparent is the current tax and NIC treatment of tips.
- 6.2 We have previously commented on the complexity that arises due to the differing tax and NIC treatment depending on the form of the tip.<sup>8</sup> Yet the differing outcomes may be considered somewhat arbitrary as the underlying nature of the tip, in many people’s minds, is essentially one and the same thing – a voluntary payment given by a customer, over and above the amount of the bill. Moreover, how the tip is left is often something the worker has no control over. It strikes us that there have been a number of changes to tipping habits in recent years – the increased use of credit cards/chip and pin machines and the advent of the service charge for example, mean NIC deductions are now the norm rather than the exception, which leaves workers comparatively out of pocket. The differing outcomes can then often be compounded due to the knock on effects for tax credits and Universal Credit, as mentioned previously, and also things like student loan repayments.<sup>9</sup>
- 6.3 Such unclear and unfair rules can leave workers feeling confused and disenfranchised with the system – from a ‘tax morality’ perspective, not where any of us want taxpayers to be. Furthermore, we would put it to BIS that it is not clear to workers as to why tips are taxable in the first place. To workers, tips are probably seen as something more akin to a ‘gift’ rather than employment income. The decision in *Revenue and Customs Commissioners v Annabel’s (Berkeley Square) Ltd*<sup>10</sup> where it was found that employers must pay their staff members at least the national minimum wage, regardless of any tips, does nothing to help this understanding and in fact could confuse workers as to whether tips are employment ‘income’ in the ordinary, natural meaning of the word.
- 6.4 **Thinking holistically then about worker wellbeing, we suggest there is a case to be made for reviewing the entire tax and NIC ‘tip’ framework and urge BIS to work with HMRC towards this longer term aim.**<sup>11</sup> A simpler system overall could help improve the understanding and outlook of these low paid workers and encourage better future compliance behaviour in the process.
- 6.5 We are very happy to discuss any aspect of our comments and to take part in any further consultations on this area.

LITRG  
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<sup>8</sup> See here for example: <http://www.litr.org.uk/latest-news/submissions/140909-remuneration-practices-%E2%80%93-call-evidence>

<sup>9</sup> Our understanding is that where tips are included within the employer’s payroll then they would count for the purposes of looking at the student loan repayment threshold. If a separate troncmaster payroll is run and is treated as an unconnected employment then student loan repayments follow the NIC rules and you would not cumulate them, meaning they are probably ignored. If cash tips are shown on a self-assessment tax return as other income and income is below a £2,000 threshold then the amounts are not included when looking at the student loan repayment threshold. If the amounts are above £2,000 then the whole amount is included when calculating whether the student loan repayment threshold has been reached.

<sup>10</sup> <http://www.bailii.org/ew/cases/EWCA/Civ/2009/361.html>